



Central Bank of Kenya

Kenya Financial Sector Stability Report

“Resilience Amid Global Realignments,
Emerging Risks, and Regulatory Reforms”

August 2025



ABOUT THE FINANCIAL STABILITY REPORT

The Kenya Financial Stability Reports provide an assessment of the country's financial system stability by the Financial Sector Regulators in compliance with the Central Bank of Kenya Act, Section 4(2) and the Financial Sector Regulators Memorandum of Understanding (MOU) of 2009 (Revised in 2013). Maintaining and safeguarding financial system stability is vital in fostering the development of a vibrant, sound and stable, and inclusive financial sector that enables Kenya meet her national development goals in a sustainable manner. The Financial Sector Regulators Forum (FSRF) established vide the MOU provides a mechanism for collaboration and cooperation in information sharing, prudential supervision, financial stability and financial inclusion issues, among other areas of mutual interests. The Forum's members are; the Capital Markets Authority (CMA), Central Bank of Kenya (CBK), Insurance Regulatory Authority (IRA), Retirement Benefits Authority (RBA) and Sacco Societies Regulatory Authority (SASRA). The National Treasury and Economic Planning, Department of Cooperative Development, Kenya Deposit Insurance Corporation (KDIC) and The Policyholders Compensation Fund (PCF) are Associate Members of the Forum. The information contained in this annual publication may be reproduced without restrictions provided due acknowledgement is made of the source. Any enquiries concerning the Kenya Financial Stability Reports should be addressed to: –

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EXECUTIVE SUMMARY

The Financial Stability Report 2024 provides an assessment of developments and risks in the Kenyan economy and financial sector in 2024 and during first half of 2025. The global economy and financial systems faced headwinds from protectionist policies, trade tensions, uncertainty in trade policy, uneven easing of monetary policy and lack of consensus on fiscal policy. The trade tensions heightened as a result of United States of America (USA) imposing tariffs on 185 countries, prompting other countries to adopt protectionist measures. This came on the backdrop of concerted efforts toward globalisation and trade integration, to foster growth and development. Protectionist policies and uncertainty in trade policy slowed down growth, increased inflation and volatility in stock prices. Inflation has been easing unevenly across most economies, leading to monetary policy easing. This will increase liquidity and lending as well as support economic growth.

The risks to financial systems are expected to decline with monetary policy easing. However, protectionist policies and uncertainty in trade policy are expected to slow down growth, precipitate investment outflow from developing and emerging markets to advanced economies. This is expected to introduce risks to the financial sector. In addition, narrow fiscal space, lack of consensus on taxation and public spending policies to enhance fiscal sustainability and support

vulnerable firms and household is imposing a drag on economic growth and financial stability.

In the East African Community (EAC), the economies were resilient to tight monetary policy, narrow fiscal space, geopolitical tensions and protectionist policies, as reflected in growth averaging 5.5 percent in 2024. The financial sector in 2024 was resilient supported by monetary, fiscal and financial sector policies as well as growth. However, private sector credit growth declined due to elevated credit risk, high cost of credit, tight lending standards and low capacity to borrow by firms and households. The economies are expected to expand in 2025 as a result of conducive weather and supportive fiscal and monetary policies. The recovery of the economies will increase the capacity of households and firms to repay loans and borrow. The increase in cross boarder banking operations and interlinkages in the payment system are expected to support regional trade and integration and also contribute to growth of the economies.

Domestically, Kenya's economy was resilient to domestic and global shocks, expanding by 4.7 percent in 2024 compared to 5.7 percent in 2023 on account of robust growth of transport and storage, finance and insurance, information and communication, and accommodation and food services. Agriculture sector also recorded strong recovery due to conducive weather. Growth is projected at 5.2 percent in 2025 on account of strong performance in agriculture

and other key sectors due to favourable weather, supportive policies, easing financial conditions and supply chain constraints. Downside risks to this growth include narrow fiscal space, fiscal consolidation, tight liquidity conditions in the international market, unpredictable weather patterns and political risks. Additionally, tightening lending standards may reduce private sector credit, which supports economic growth and financial sector.

Kenya's financial system was sound, stable and resilient to interest rates shock and elevated credit risk in 2024. The banking sector was profitable with sufficient capital and liquidity buffers. The sector however recorded elevated credit and operational risks. The microfinance banks incurred losses and their capital declined during the period. In the capital markets, equity prices and market capitalisation improved, with collective investment schemes recording 81 percent growth in assets. Similarly net foreign investor participation increased from 48.9 percent in 2023 to 50.9 percent in 2024. The corporate bonds market was inactive, while turnover and prices for government bonds increased, contributing to the recovery in the growth of assets for pension and insurance sectors. In the pension sector, membership increased while assets grew by 30 percent, despite a decline in member contributions. Performance of the insurance sector improved in terms of return on investment and gross premium. However, the combined ratio was above 100 percent implying that the claims and expenses exceeded the premiums earned due to operational inefficiency and inaccurate

assessment of risk. In addition, the sector recorded an increase in technology and cyber related fraud. Assets quality and profitability of Saccos improved in 2024 despite increase in cost of living and unemployment. The financial markets infrastructure continue to play its vital role of facilitating safe, successful, effective and efficient settlement of transactions. The Dhow CSD continues to efficiently facilitate purchase and sell of government securities in the primary and secondary markets, enabling new investors to participate in the markets, improving liquidity management, and establishing yields that better reflect market conditions. In this regard, the DhowCSD is continuous to contribute to financial sector deepening, inclusion and stability.

Kenya's financial sector is expected to be sound and stable in 2025, with adequate capital and liquidity buffers, due to robust growth and regulatory measures. The implementation of the Business (Amendment) Act 2024 is expected to increase capital for banks and enable them effectively intermediate funds in the economy and support development projects. The operationalisation of SACCO Central to provide liquidity facility, shared technology platform, and payment solutions is expected to enhance stability and growth of SACCOs.

The downside risks to the resilient growth and sustained financial sector stability in 2025, however remain. The protectionist measures, trade policy uncertainty, geopolitical tensions, narrowing fiscal space, technology-related

risks, and geo-economic fragmentation could have implications on the domestic economy and the financial sector outlook. A careful policy balancing involving fiscal consolidation to address public debt sustainability concerns, reforming trade policy to address concerns of trading partners and promote economic growth and efficiency and strengthening regulatory framework to mitigate risks associated with technology, will enhance financial stability.

Table i: Macrofinancial Indicators

	2020	2021	2022	2023	2024
Macro Economic Indicators					
Real GDP Growth	-0.3	▲ 7.6	▼ 4.8	▲ 5.6	▼ 4.7
Headline inflation	5.6	▼ 5.7	▲ 9.1	▼ 6.6	▼ 3.0
Debt/GDP	67.9	▲ 68.2	▼ 67.8	▲ 74.1	▼ 67.3
KES/USD	110.6	▲ 112.9	▲ 125.5	▲ 154.1	▼ 129.3
Average t bill rates	6.9	▲ 7.3	▲ 9.3	▲ 15.7	▼ 10.3
10 year yield	10.5	▼ 9.9	▲ 11.7	▲ 16.9	▼ 12.6
Public Sector Credit growth	38.8	▼ 30.3	▼ 12.2	▼ 11.1	▼ 4.5
Private Sector Credit growth	8.4	▲ 31.3	▼ 12.3	▲ 13.5	▼ 0.9
Lending Rate	12.0	▲ 12.2	▲ 12.7	▲ 14.6	▲ 16.9
Capital Markets Indicators					
NASI	152.1	▲ 166.5	▼ 127.5	▼ 92.1	▲ 123.5
Net Foreign Investor participation to total equity turnover	64.7	▼ 57.1	▼ 54.2	▼ 48.9	▲ 50.9
Liquidity	6.4	▼ 5.3	▼ 4.9	▲ 5.6	▼ 5.3
Bond index					1107.4
Bonds turnover ratio	2.3	▼ 1.6	▼ 1.3	▼ 1.1	▲ 2.3
Banking Indicators					
Capital Adequacy ratio*	19.0	▲ 19.5	▼ 18.9	▼ 18.6	▲ 19.6
NPLs Ratio	14.1	▼ 13.1	▲ 13.3	▲ 15.6	▲ 17.1
Return on Assets	2.1	▲ 3.3	▲ 3.7	▼ 2.9	▲ 3.4
Return on Equity	13.9	▲ 22.0	▲ 26.2	▼ 22.4	▼ 22.0
Deposit Growth	13.2	▼ 10.4	▼ 6.5	▲ 22.9	▼ -1.3
Insurance					
Combined ratio	101.3	▲ 106.2	▲ 103.3	▲ 103.9	▲ 107.5
Pensions					
Overall risk core	3.2	▼ 3.0	▼ 3.0	▼ 2.9	▼ 2.7
SACCO Indicators					
Deposit growth	13.1	▼ 9.8	▲ 10.4	▲ 29.7	▼ 10.7
Growth in NPLs	26.9	▼ 7.6	▲ 36.8	▼ -8.3	▲ 19.7
KDIC Indicators					
Coverage ratio	18.2	▲ 21.7	▲ 24.0	▲ 24.4	▲ 30.3
Payment Systems Indicators					
Growth in KEPSS value of transactions	1.7	▲ 4.7	▲ 10.1	▲ 19.4	▼ -0.4

* Regulatory minimum 14.5 percent

▲ Improvement

▼ Worsening

1. ECONOMIC AND FINANCIAL CONDITIONS

1.1 Global Conditions and Risks

The global economy is projected to slow down in 2025 to between 2.8 - 3.0 percent in 2025 compared to a growth of 3.3 percent in 2024, despite inflation returning to target. The slow down is notably due to increase in trade tension, protectionist measures and policy uncertainty (IMF, July 2025 WEO, OECD, 2025 and World Bank-2025). Global Trade increased by 3.7 percent in 2024, supporting livelihoods, income and providing required intermediate goods in the supply chain. However, USA imposed tariffs on 185 countries with a possibility of revising them. Some countries in response have either imposed reciprocal tariffs or non-tariff barriers not only on USA goods and services but also to other trading partners. The protectionist measures and the uncertainty in trade policy is expected to reduce global trade and investment, especially in developing countries. The trade tensions increased volatility in major financial markets, with volatility index increasing from 12.8 in January 2024 to 20.3 in November 2024. Despite the index declining to 14.9 in December it increased to 43.5 in April 2025. The protectionist policies in advanced and emerging economies elevate risks in developing countries and discourages value addition in primary goods, which reduces their competitiveness on the global market.

The uncertainty surrounding government policies and regulations especially regarding taxation, fiscal consolidation to put economies towards a sustainable fiscal path and public

spending to support vulnerable households and firms are also expected to slow down growth and introduce risks to the financial sector in 2025. The legacy debt and fiscal deficits during the COVID-19 period increased debt levels, which require fiscal consolidation to enhance sustainability of fiscal policy. However, there is no consensus on tax measures and spending priorities. In addition, there is low public acceptance of tax measure and expenditure reforms in countries that require them to achieve fiscal sustainability. The reforms in public spending in advanced economies such as the USA has increased public spending pressure. The most affected sectors are healthcare education and security, which accentuate debt distress, especially in countries relying on grants and official development assistance. The geopolitical tensions in the Central Africa, Middle East and Russian-Ukraine war disrupted supply chain for final and intermediate goods, which not only increased transport cost but also prices of final goods and services. Disruptions in the supply chain and increase in prices of goods and services reduce purchasing power on the one hand. On the other hand, monetary policy may not be eased fast enough due to persistence in inflation. Delays in easing monetary policy elevate cost of funds needed by the private and public sector to catalyse growth and improve their financial soundness

Policy uncertainty and trade tensions have broad implications for financial stability. Restrictions to trade reduce not only market access for export-oriented firms, but also

affects factor incomes, which are crucial for meeting financial obligation. The shifting of firms from countries with high tariff to other advanced economies with favourable taxation policy, accentuate unemployment and volatility in the stock market as firms exit. In addition, the reduction in market access as a result of tariff and non-tariff barriers reduces earnings for firms and households which reduces their creditworthiness. The emerging and developing countries as well as primary goods exporters face significant decline in earnings and capital outflow as result of trade tensions and geopolitical uncertainty.

The East African Community (EAC) economies were resilient to geopolitical tension, narrow fiscal space and slow growth in private sector credit to grow at an average of 13.6 percent in 2024 from an average growth of 16.4 percent in 2023. The slowdown in private sector credit growth was due to tight monetary policy, tight lending standards to mitigate credit risk and slow growth, which reduce the capacity of firms and households to borrow. The EAC growth was underpinned by conducive weather, which supported agricultural production and public spending in policy priority areas. The region's growth is projected at an average of 8.8 percent in 2025, supported by rebound in Agriculture, global economic recovery, easing inflationary pressures, and improved financial conditions. The resilient growth is expected to alleviate credit risk. The downside risks to the projected growth include elevated food and energy prices, lack of fiscal space to support growth, geopolitical tension and protectionist policies.

The financial sector was resilient supported by robust growth and regulatory measures, which enhanced the capacity of financial institution to withstand shocks. The assets of the banking sector grew by an average of 10.0 percent in between 2024 and 2023, while liquidity and core capital adequacy ratio increased by 38.3 and 20.0 percent, respectively which is above the regulatory minimum of 10.5 percent. The quality of assets however, deteriorated, with the ratio of NPLs increasing from an average of 6.2 percent in December 2023 to 7.3 percent in December 2024 indicating elevated credit risk. However, coverage ratio increased from 42 percent in 2023 to 44 percent in 2024, while liquidity ratios were above the national regulatory minimum indicating that the banking sector has sufficient liquidity and capital buffers to withstand shocks. In addition, the regional stress test results indicate that the banking sector in the EAC is resilient to credit and exchange rate risks in the moderate scenarios.

Overall, a careful policy balancing between stemming inflation through tightening policy rates and maintaining accommodative monetary policy is needed for sustained economic recovery and financial stability in major economies. This will enhance stability in prices, strengthen growth, increase demand for Kenya's exports, remittances and investment in Kenya, which will ease financial conditions. The EMDEs remain vulnerable to a disorderly tightening of global financial conditions and fiscal reforms in the developed countries, which have reduced grants and budgetary support to security, education, health care

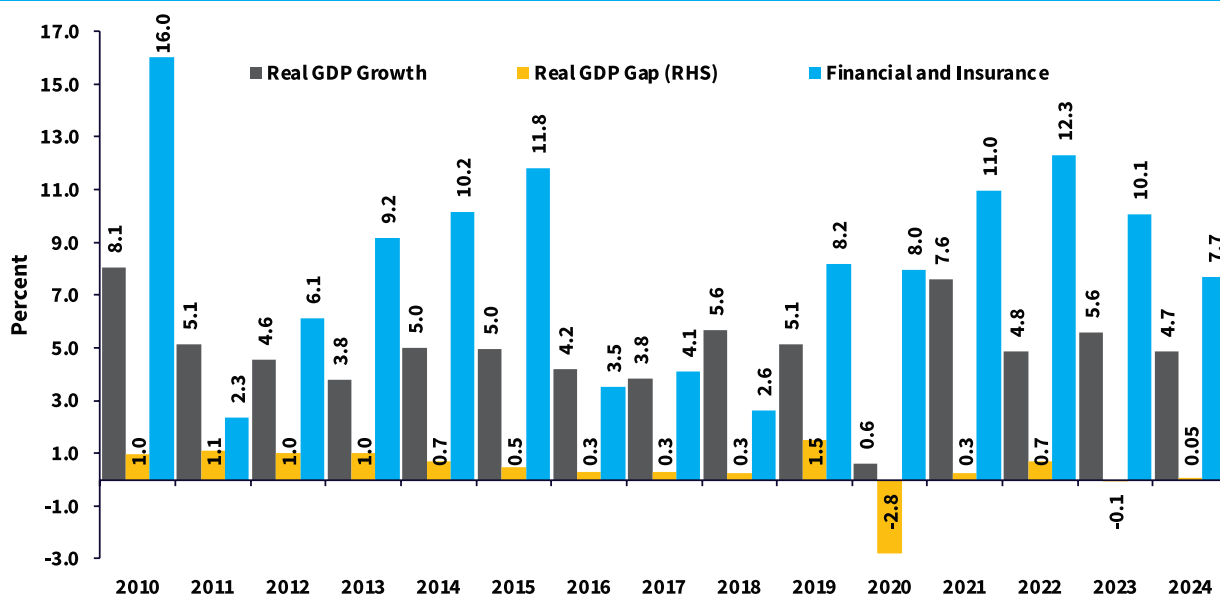
and social services. These reforms provide an opportunity for EMDEs to reform their fiscal policies and reduce reliance on grants. The protectionist measures and trade uncertainty require the EMDEs to reform their trade policies and intensify efforts for regional integration to increase trade amongst EMDEs at regional and continental level. Additionally, fiscal prudence in economies with high inflation, high debt level and tightening financial condition is urgent. But fiscal support to that part of the population and firms in the sectors where recovery was already weaker remains critical, hence striking a balance between containing

vulnerabilities and avoiding procyclicality lingering risks growth prospects.

1.2 Domestic Economic Conditions and Risks

The domestic economy grew by 4.7 percent in 2024, a 0.7 percentage point decrease from 5.6 percent growth in 2023. Key drivers to this decrease were under performance of the real estate sector, information and communication sector, construction sector and agriculture (Figure 1).

Figure 1: Kenya's Economic Performance



Source: Staff computation

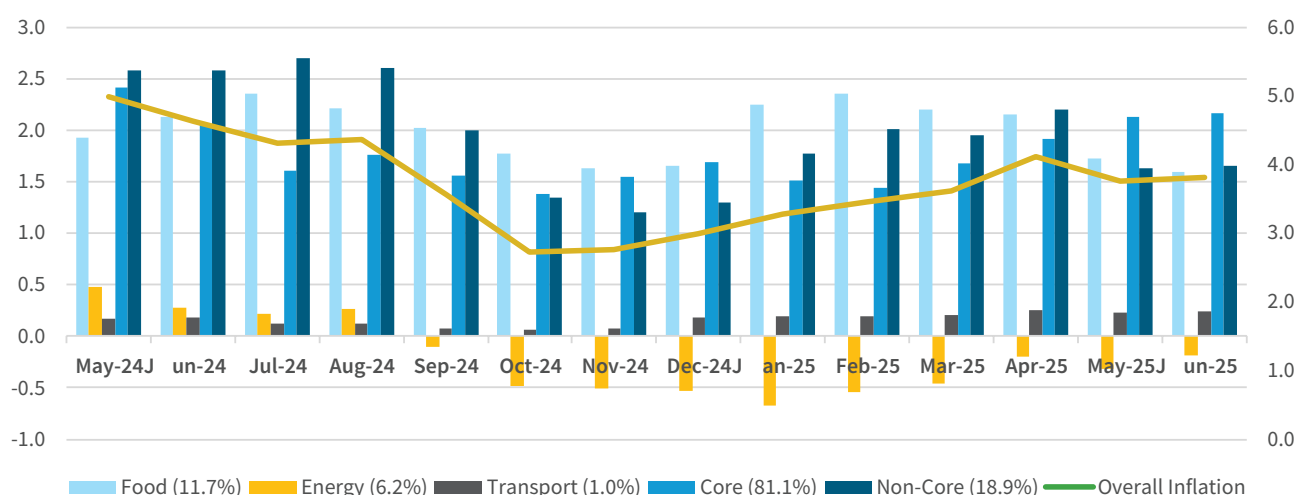
Despite conducive weather conditions and supportive policies, the economy faced high cost of production due to high energy prices, tight financial conditions, delays in government payments to suppliers and lack of fiscal support to the vulnerable groups, thus moderating overall growth in 2024.

Kenya's economy is projected to remain resilient in 2025, to grow by 5.3 This growth is however dependent on developments in the domestic and global prices of commodities, monetary policy stance, fiscal consolidation, and credit market conditions. Further supply chain disruptions as a result of heightened

geopolitical conflicts, geoeconomic fragmentation amid trade tensions could constrain smooth flow of imports, impacting negatively on supply of cereals, fertilisers, metals, and oil, among other intermediate commodities. This could increase cost of production and elevate inflation resulting to central banks slowing down easing of monetary policy rates (**Figure 2**). The spillover could reduce the capacity of households and firms to borrow and repay existing loans, while lenders tighten lending standards. Proactive

policy measures to support a vibrant economy that creates jobs for the young people, ease cost of living concerns and enable households and firms to borrow for investment, could enhance the resilience of the economy and increase the capacity borrow, service their existing loans and thus reducing loan delinquencies. A resilient economy would contribute to the improvement in the balance sheet of financial institutions and intermediation of financial services.

Figure 2: Inflation mainly driven by Fuel Prices (Percent)

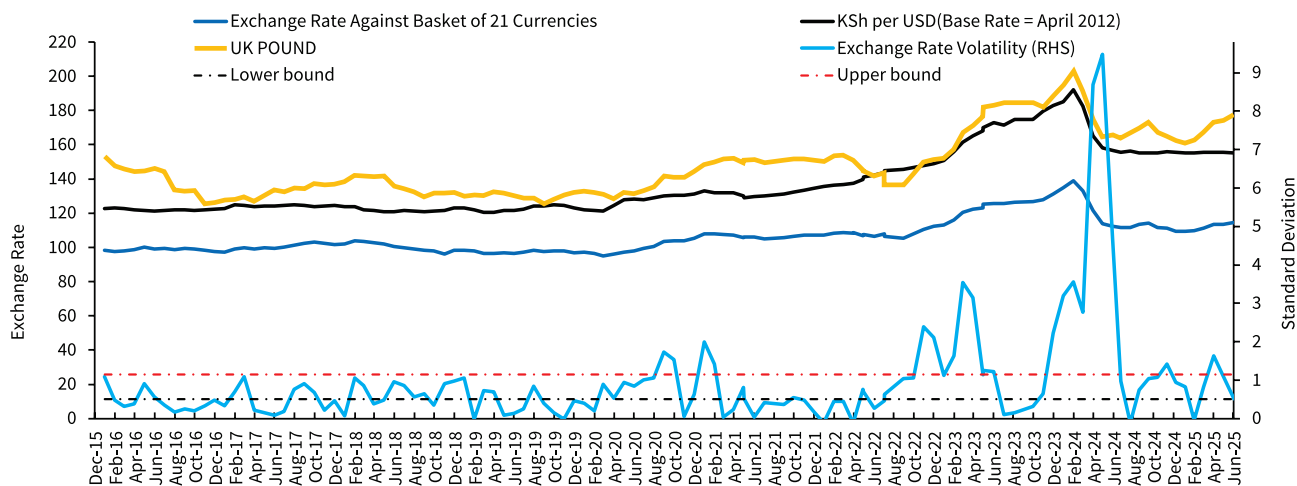


Source: CBK

The Kenya Shilling was stable against regional and international currencies on account of pause in monetary policy tightening in advanced economies, steady inflow of diaspora remittances, narrowing current account deficit, financial markets reforms, and prudent and well-coordinated fiscal and monetary policies. In addition, the prudent and well-coordinated

fiscal and monetary policies reduced volatility in exchange rate, which enabled the efficient functioning of the foreign exchange market. The exchange rate was resilient to large purchases and sales, with net open position averaging within USD ± 50 in 2024 (**Figure 3**).

Figure 3: Kenya Shilling Exchange Rate



Source: Staff computation

Private sector credit recorded annual growth rate of 0.9 percent in the year to December 2024, 12.6 percentage points lower than the growth rate for similar period in 2023. This downward trend has however reversed, recovering to annual growth rate of 4.4 percent in the year to June 2025 in response to easing monetary policy conditions (Table 1). The main sectors driving the decrease in credit growth in 2024 compared to 2023 were Mining and Quarrying, Finance and Insurance, Building and Construction, Manufacturing, and Business Services. The tightening of lending standards and challenging business environment mainly led to the decline in private sector credit. The decline in private

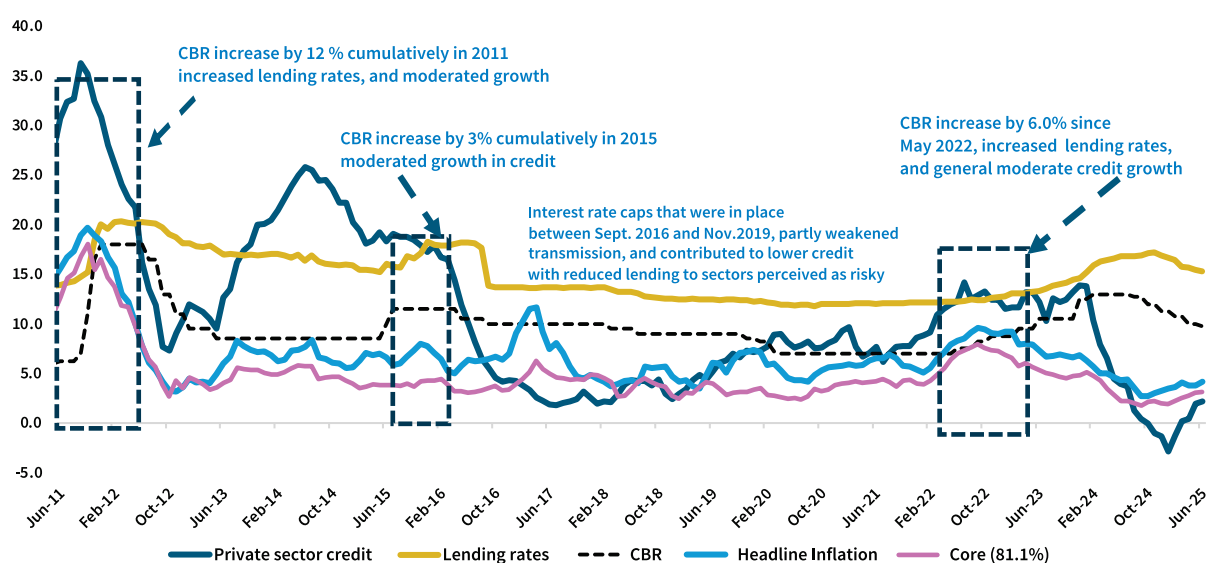
sector credit has a contractionary impact on the economic activity, which accentuate impairment of assets and capacity to borrow. Lending is concentrated in manufacturing, trade and households, accounting for 54.7 percent of the private sector credit. These sectors are vulnerable to slowdown in economic activity, change in trade policy, geopolitical developments, remittances and have strong linkages with other sectors in the economy. Hence, concentration of credit in manufacturing, trade and households, predisposes lenders to shocks emanating from the real sector such as change in trade policies in advanced, emerging market and East African economies.

Table 1: Annual Growth in Credit to Private Sector (Percent)

Sectors	Shares in credit June-25													
		Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
Agriculture	3.1	12.5	17.0	22.3	14.9	19.4	15.5	22.5	15.9	8.6	5.9	1.1	8.5	9.7
Manufacturing	12.3	15.2	14.2	13.8	15.8	18.0	22.0	20.8	9.5	(0.5)	(14.3)	(12.1)	(5.4)	3.0
Trade	14.4	11.6	16.4	11.4	11.9	9.2	6.7	12.5	5.7	3.0	5.9	0.3	6.2	7.3
Building & construction	3.3	13.9	12.5	8.2	5.8	3.8	8.1	8.7	0.6	(7.5)	(13.6)	(13.9)	11.6	21.7
Transport & communication	6.9	22.2	21.6	23.5	17.4	19.6	18.3	20.5	6.7	4.3	1.4	(4.0)	5.7	(2.6)
Finance and insurance	2.9	6.5	0.2	7.6	28.4	29.9	40.7	60.1	12.9	3.2	0.4	(24.7)	(18.0)	(7.1)
Real estate	9.3	0.5	0.1	3.2	2.3	3.4	7.2	6.8	4.9	3.4	2.2	(1.3)	3.1	1.0
Mining & quarrying	0.5	28.5	57.4	31.3	83.2	24.5	21.1	15.0	34.0	110.0	95.2	(28.5)	(43.8)	(47.3)
Private households	27.8	6.1	7.8	8.2	7.2	10.9	10.4	7.4	19.6	8.2	10.5	11.1	7.1	8.4
Consumer durables	9.4	14.7	14.4	12.9	12.7	12.7	10.6	9.9	6.3	3.3	2.7	3.2	9.0	9.4
Business services	4.0	15.2	12.5	13.7	9.3	12.1	11.5	7.6	6.8	1.7	(2.8)	(9.9)	(12.3)	(10.3)
Other activities	5.9	57.2	53.8	41.8	11.9	8.3	4.6	18.4	27.1	25.8	6.2	36.8	(5.9)	4.6
Total Private Sector Credit	100.0	12.3	12.9	12.5	11.6	12.0	12.2	13.5	11.5	5.4	2.6	0.9	2.4	4.4

Source: CBK

The Central Bank introduced reforms in the interbank market in July 2023 to deepen financial markets and maintain stability and align the interbank rate with the Central Bank Rate (CBR). This entailed establishing the corridor of 2.5 percent within which the interbank rate can fluctuate around the CBR in July 2023. The upper and lower limit of the interbank rate was reduced from 2.5 percent to 1.5 percent around the CBR (Figure 4).

Figure 4: Trends in Annual Growth in PSC, Lending Rates and CBR (Percent)

Source: CBK

Additionally, haircut on government securities pledged as collateral has reduced from 10 percent and 20 percent for Treasury bills and bonds to 2 percent for instrument that mature within one year, 5 percent for 1- 10 years and 30 percent for 10- 30-year maturities. More, importantly the reduction of the interbank rate corridor to closely align the interbank rate to the CBR strengthened the transmission of monetary policy stimuli to the interest rates in the economy. This also aligns the interbank interest rate to the discount window rate, which enhances transparency and efficiency in liquidity management in the financial sector and encourage financial institution to seek funds from the CBK as a lender of last resort. The horizontal repos market has been deepened by leveraging on the *DhowCSD (is a Central Security Depository for Government Securities.)* to facilitate transfer collateral from the borrower to the lender. This has increased interbank transactions, enabling financial institution to effectively manage their liquidity as well optimise on liquidity holdings. Prior to *DhowCSD* rollout in July 2023, government securities used as collateral in the interbank borrowing was not transferrable. As a result, counterparties demanded large haircuts and, in some cases, transactions only took place on relationships, leading to market segmentation. The *DhowCSD* facilitates collateral transfer among counterparties, enhancing confidence in the interbank market that borrowers will meet their obligation and if they fail, lenders can liquidate the collateral. As a result, the collateralized interbank market (Horizontal Repos market) transactions increased from an average KSh 16 billion in 2023 to KSh 32 billion

2024, and in maturities ranges from overnight to 32 days. This has enabled banks to manage liquidity through the interbank market using government securities as collateral, while minimising counter party, liquidity and market risks.

Despite the *DhowCSD* enabling the transfer of security to the lender efficiently, the average haircut on the horizontal repo market increased marginally from 79.1 percent 2023 to 81.3 percent in 2024. The hair cut and the lending rate also differentiated on the interbank market according to bank size. The hair cut for large banks' lending to other large banks increased from an average of 86.1 percent to an average of 88 percent and the associated interest rate declined from 12.2 percent to 11.0 percent, in 2023 compared to 2024. The haircut for large banks lending to small banks was 73 percent and interest rate of 15.0 percent in 2023, while in 2024 the haircut increased to 74 percent and declined to 14 percent. Large banks also lend to medium size banks at a haircut of 77 percent and interest rate of 13.7 percent. Hence, reforms in the interbank market and operationalisation of *Dhow CSD* has improved efficiency of the interbank marginally.

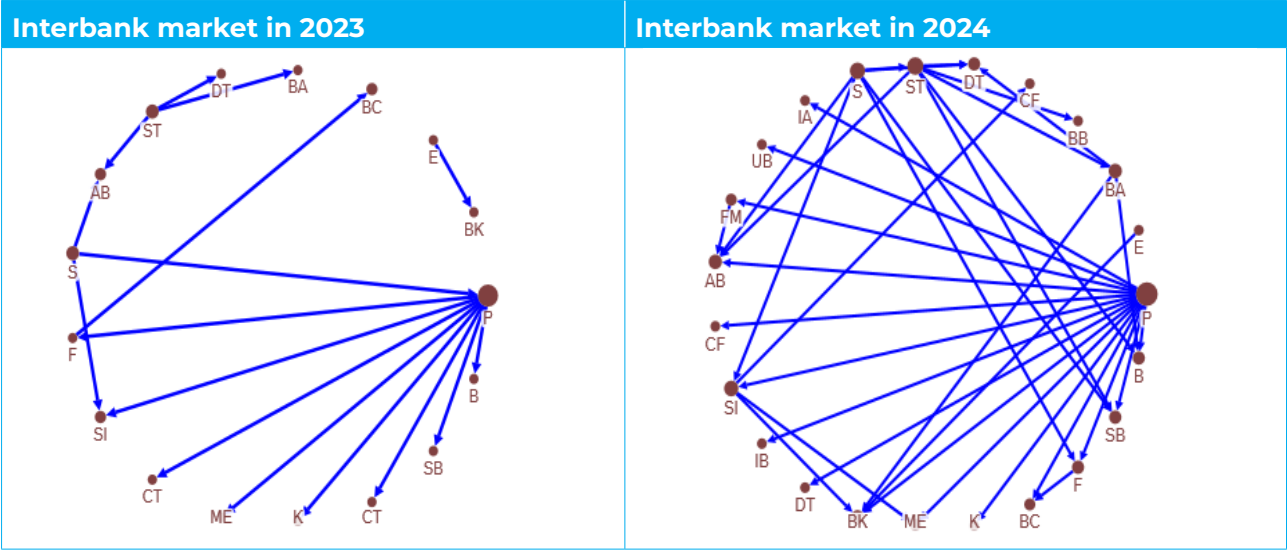
However, segmentation of the interbank market persisted in 2024. On average, a bank seeking liquidity had one intermediary in 2023, instead of borrowing from a counter party (bilaterally given the collateral provided). However, in 2024, the number of intermediaries increased to two and number of actual counter parties in relation to possible counter parties declined from 10 percent in 2023 to 8 percent

in 2024. The number of intermediaries a peripheral bank has to go through to obtain liquidity increased from 1 in 2023 to 2 in 2024 **(Figure 5).**

The interbank market was dominated by one large bank as a lender to a small intermediary bank. The small bank intermediated funds between the dominant lender (supplier of liquidity) and other borrowers in the interbank market. Whereas small banks relied on the intermediary to borrow from one dominant lender, large banks borrowed bilaterally from other large, medium and small banks.

The persistence segmentation reduces efficiency of the interbank market, resulting to the existence of excess liquidity in some banks while other banks have liquidity shortage. Banks unable to obtain affordable and sufficient liquidity in the interbank market resort to borrowing from the CBK, which interferes with effectiveness of monetary policy and growth and development of the interbank market.

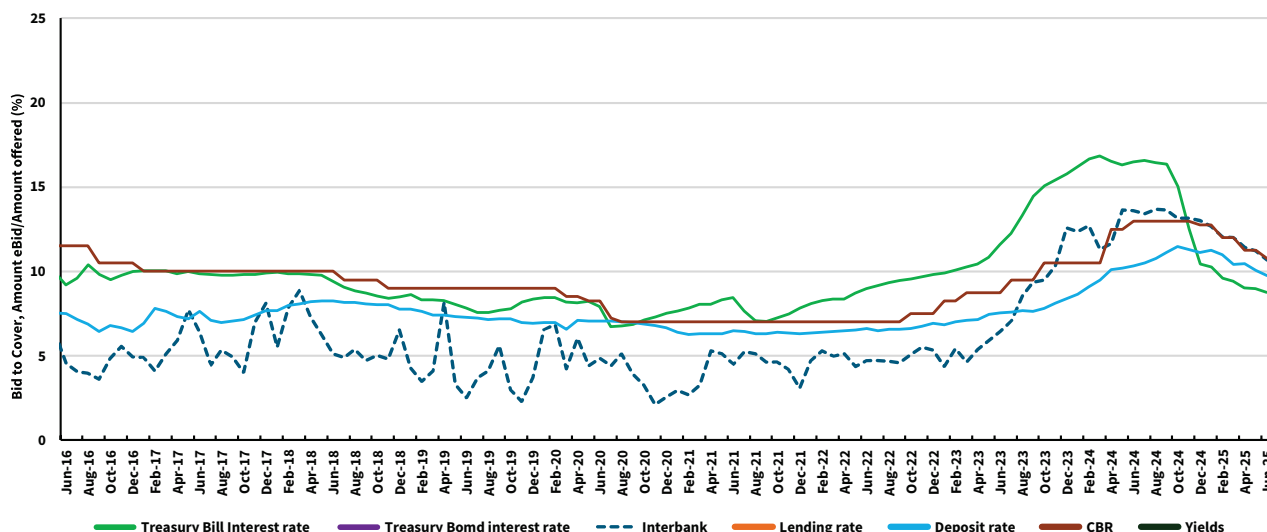
Figure 5: Development in the Horizontal Repurchase agreement interbank Market



Source: CBK

The decline in interest rates from second half of 2024, are reflective of the monetary policy easing to stem inflationary risks and fiscal pressures on high government borrowing. These has led to lending rates aligning to the monetary policy stance. In addition, banks raised deposits rates to historical high of above 12 percent to attract and retain deposits, which were facing competition from high coupon rates offered on treasury bills and bonds **(Figure 6).**

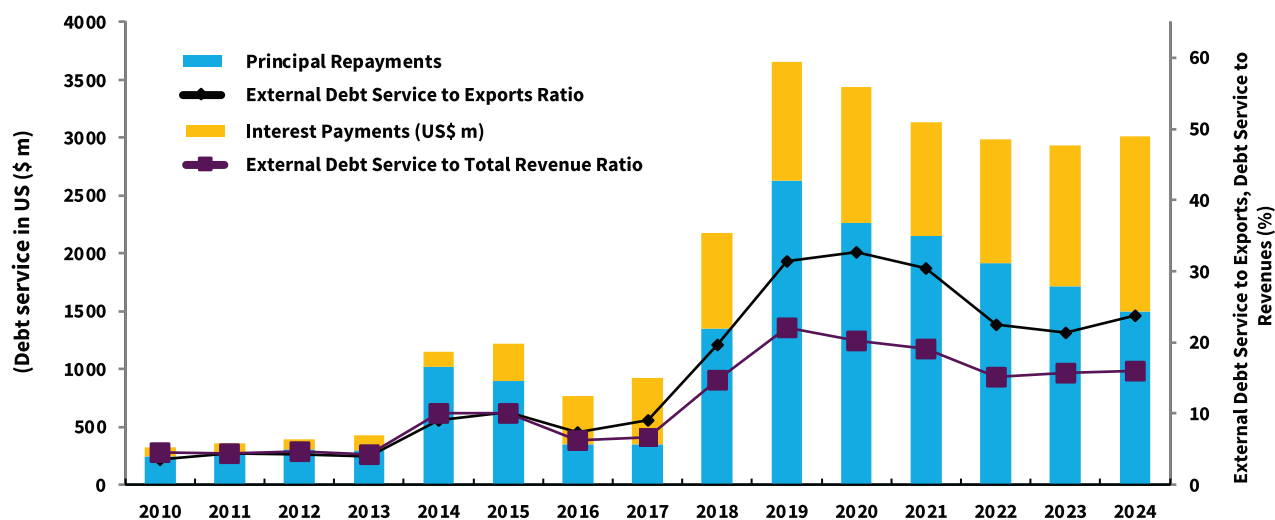
Figure 6: Trends in Key Interest Rates (Percent)



Source: CBK

The fiscal space remained tight in 2024 and first half of 2025 on account of slower growth in revenues and increased debt repayment. The ratio of external debt service to exports and debt service to total revenue increased to 23.7 percent and 16.1 percent, respectively, in 2024 from 21.3 percent and 15.7 percent in FY 2023. The increase in interest and principal repayments in FY 2023/2024 reflect the impact of local currency depreciation on external debt. In the FY 2024/25 the Government is implementing fiscal consolidation programme, expected to attain a fiscal deficit of percent of GDP. This together with other reforms, is expected to increase public debt sustainability.

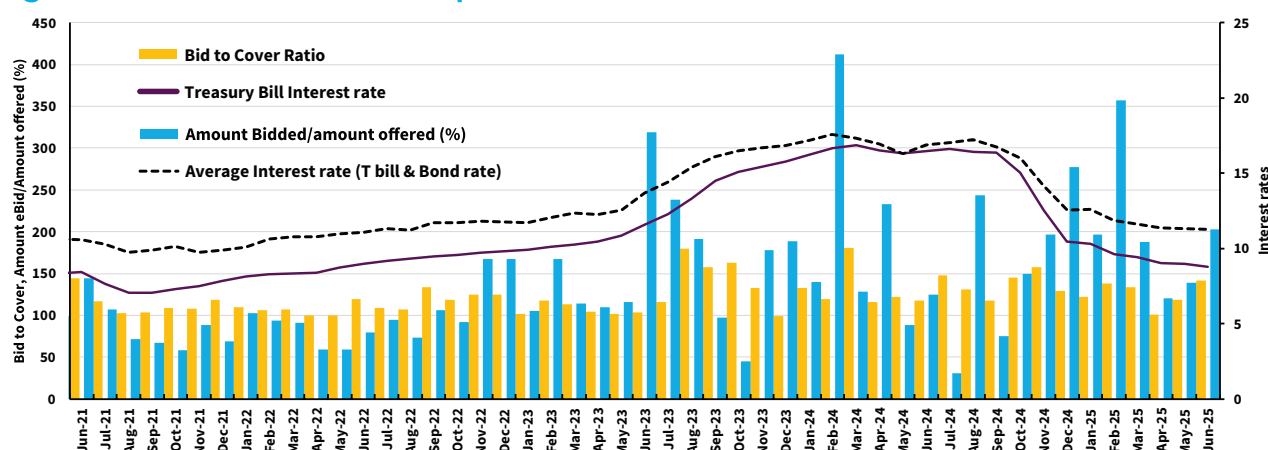
Figure 7: Public Debt Service



Source: CBK

Overall, interest rates on government securities decreased in 2024 and the first half of 2025 (**Figure 8**). For instance, Treasury bill rates for all the maturities, averaged 8.7 percent in June 2025 compared with an average of 16.5 percent in similar period in 2024. The weighted average interest rates for both T-bonds and bills decreased to 11.3 percent in June 2025 compared from 16.9 in percent in June 2024.

Figure 8: Government Securities performance

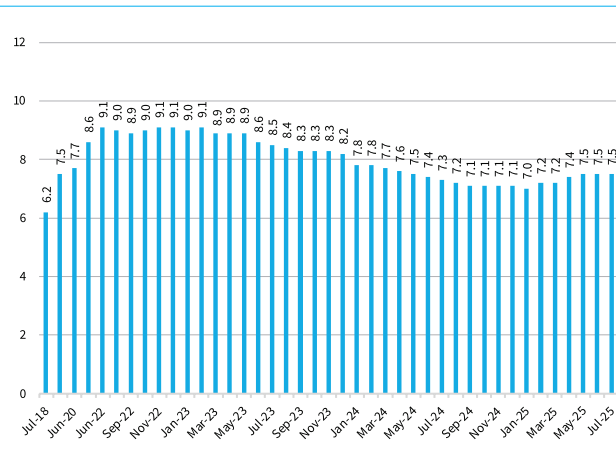


Source: CBK

The readjustment in the interest rate increases the propensity of investor to invest in shorter dated bonds. The issuance of shorter dated instrument reduced average time to maturity (ATM). The ATM for government bonds averaged 7.4 years in June 2025, compared to 7.5 years in June 2024 (**Figure 9**). The ratio of treasury bills to bonds also increased from 12: 88 in December 2024

to 17: 83 June 2025 indicating an increase in Treasury bills in the portfolio of government securities. The increase in T-bills stock was partly driven by investor preference for the longer 364 days T-bill as investors sought to lock in interest rates in a decreasing interest rates environment (**Figure 10**).

Figure 9: Average time to maturity for Government securities (Years)

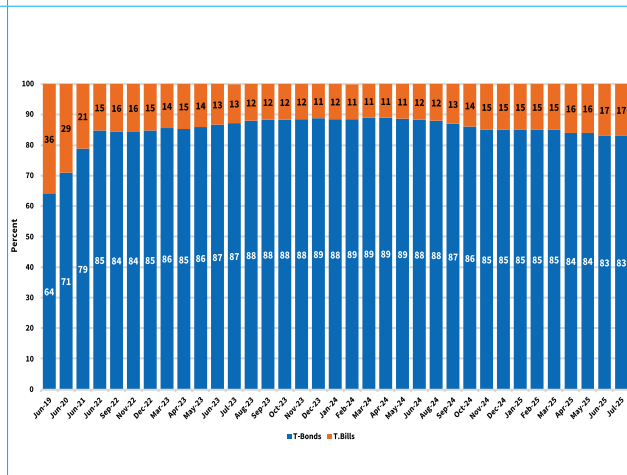


Source: CBK

This also indicates that returns are not commensurate to the risks of holding instruments with longer maturities to compensate the investor for higher duration and liquidity risks. The ATM for bonds improved marginally from 7.4 years in June 2024 to 7.5 years in June 2025. However, the increase in proportion of Treasury bills presents refinancing pressures in the short term. The refinancing risks can further be mitigated by issuing longer dated instruments to capitalise on the lower interest rate. This will also lower the cost of servicing debt in line with the Medium-Term Debt Strategy 2025-26.

The financial sector can also benefit from the decline in interest rate as a result of easing of monetary policy. The monetary policy easing results to decline in the deposit rate, lending rate, coupon rate as well as the yields, which increases mark-to-market valuation (**Figure 6**). Increase in market-to-market valuation increases liquidity of banks as well as enabling them to borrow using the bonds as collateral.

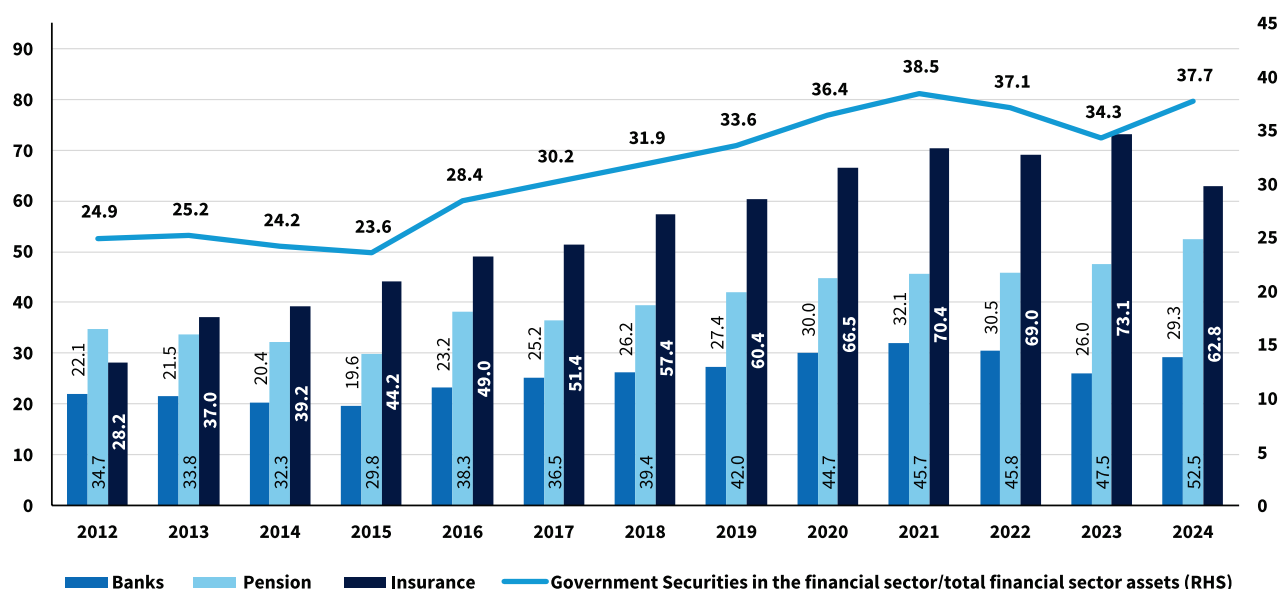
Figure 10: Ratio of Outstanding Treasury bills to Treasury bonds



The increase in the mark-to-market valuation can realised once bonds are sold, which increase profitability.

The government securities have higher returns and lower administrative cost compared to loans and advances, placements/deposits, investment in property and equities. The risk of default is also lower relative to competing assets in the portfolio. Hence, the financing sector on aggregate has higher propensity to invest in government securities and advance loans to regional, national and state-owned enterprises. The financial sector on aggregate holds 81.1 percent on average of domestic public debt between 2018 and 2024 (**Annex**), while the share on government securities in the total asset of the financial sector increased from 28.4 percent in 2026 to 37.7 percent in 2024. The insurance, banks and pension fund sectors invested 62.8 percent, 29.3 percent and 52.5 percent of their total assets in government securities (**Figure 11**).

Figure 11: Investment in Government Securities Relative to Financial Sector Assets (Percent)



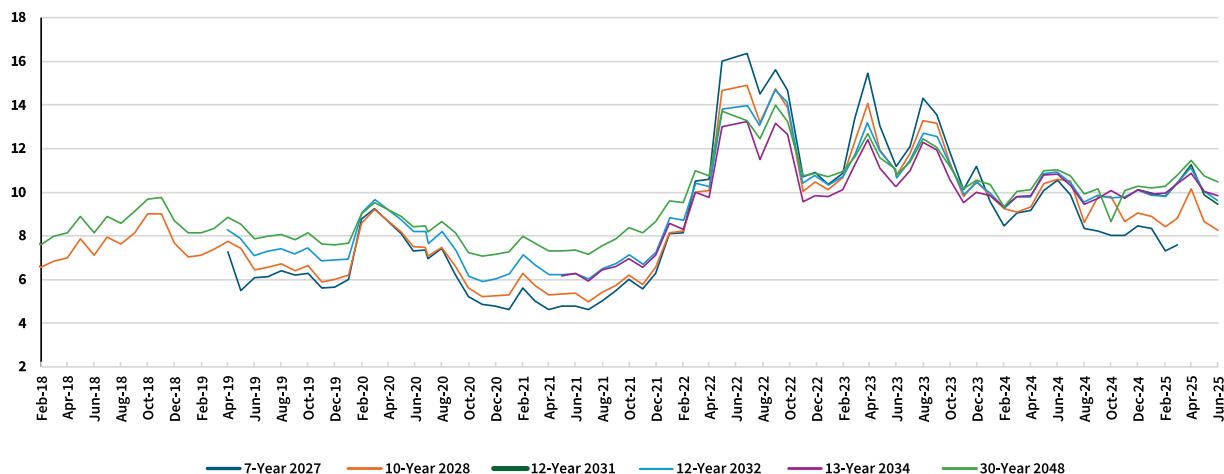
Source: CBK

On the one hand increase in holding of government securities, by the financial sector increases profitability due high returns. On the other hand, elevated risks of debt distress increase exposure of the financial sector to default risk. In addition, financial sector contributes more effectively to capital formation and economic growth by lending to the private sector. Hence, increase in the holding of government debt by the financial sector reduces amount of loanable funds available to the private sector for capital formation and consumption.

The yields on the Kenya Government Eurobonds also declined in 2024 due to easing of sovereign risks (Figure 12).

The yields on Kenya's Eurobonds were stable and declining in 2024 as investor sentiments improved about Kenya's ability to repay the bonds maturing in June 2024. In addition, declining interest rates as a result of easing inflation and financial conditions in the domestic and global economy reduced funding cost for Kenya. The successful buyback of the Eurobond in February 2024, strong demand for Kenya Shilling denominated infrastructure bond by foreign investors due to high and non-taxable coupons, and strong remittances also contributed to the reduction in yields and overall stability in the second quarter of 2024.

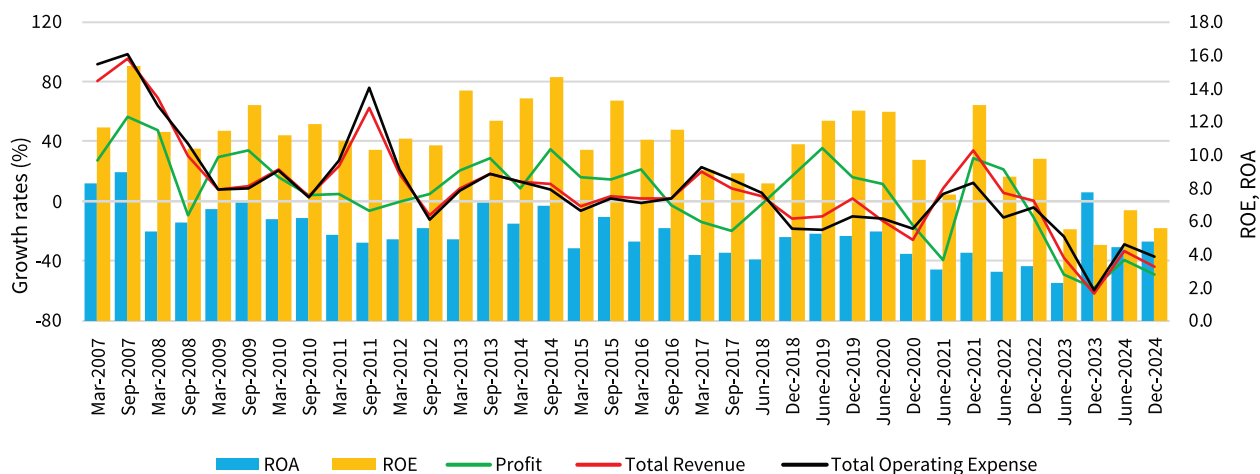
Figure 12: Eurobonds Yields (Percent)



Source: Rifinitiv

The NSE listed non-financial corporates recorded further decline in profitability in 2024, highlighting a challenging business environment (Figure 13). Profitability of the non-financial corporates listed on the NSE declined by 49.2 percent in 2024 a slight improvement from a decline of 58.3 percent in 2023.

Figure 13: Profitability of NSE Listed Non-Financial Companies



Source: NSE database

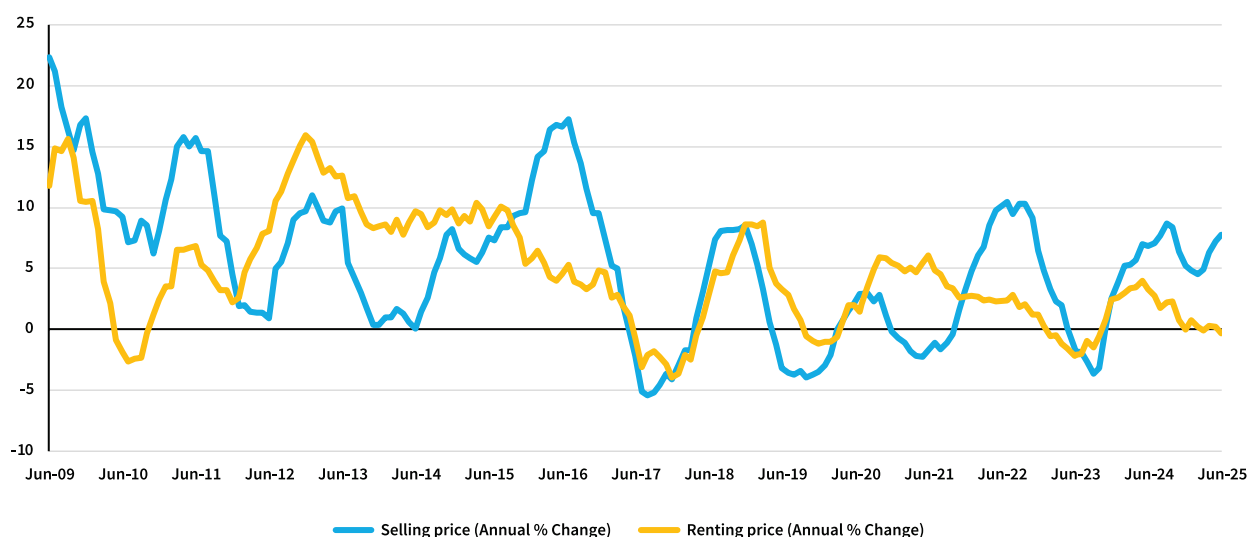
Expenses grew slower than revenue on account of, exchange rate appreciation and competition and improved operation efficiency. A total of 9 listed companies issued profit warnings in 2024 compared to 16 companies in 2023. A firm is required by the NSE to issue a profit warning if its annual profits decline by at least 25 percent from the previous year. Declining revenues, liquidity, and profitability increases indebtedness of firms, which not only reduces their ability to service debt, but also to obtain affordable loans cost from financial institutions.

The real estate remained subdued for two consecutive years to 2024, partly reflecting

low demand for commercial and residential units as some organizations moved to virtual offices, tight lending standards and elevated credit risk that was evident in the real estate sector **(Figure 14)**. The sales, purchases, rental, and occupancy rates of residential, office, retail, and hospitality real estate slowed in 2024 compared to 2023 due to the decline in demand and increasing shift from office to working from home and selling online.

Despite slowing rental prices, the shift from shops and malls to online and from office to online and homes, continued in 2023 and 2024, reducing footfall in the domestic chain stores and demand for office space.

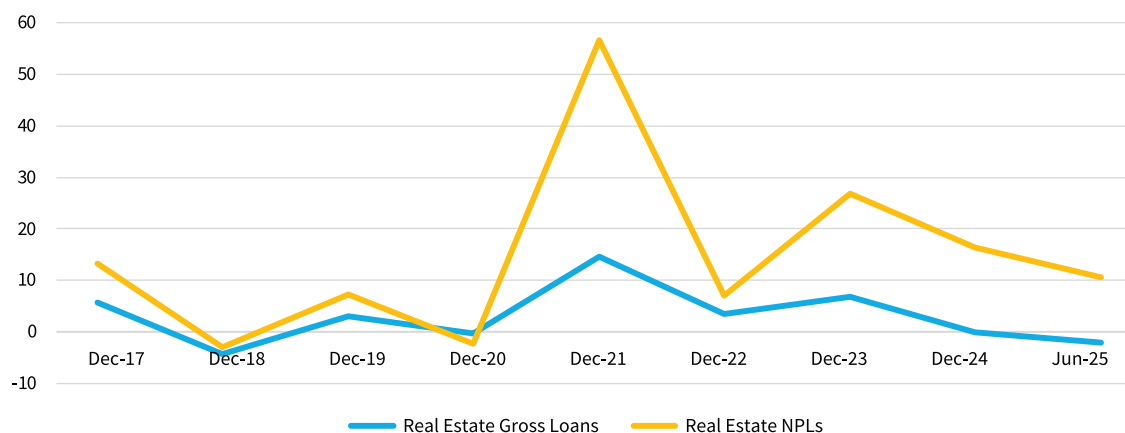
Figure 14: Hass Property Indices (Y-o-Y percentage Change)



Source: Hass Consult

The Kenya Bankers Association fixed base housing price index also indicates that the housing prices were subdued in 2024 due to high cost of credit, increase in the construction cost and low uptake of residential and commercial units. Reduced uptake of new property amid increases in construction cost has made it difficult for developers to sell their units contributing to increase credit risk. In addition, lenders also tighten standards to mitigate credit risks **(Figure 15)**

Figure 15: Growth in Real Estate Sector loans and NPLs (Percent)



Source: CBK

The real estate sector is expected to recover in 2025 and in 2026 due to resilient economy. The sector is also expected to be boosted by implementation of affordable housing programme, road construction, public spending and recovery in lending to private sector. diaspora investment is increasing being channel to the real sector to capitalise on existing housing deficit especially in the apartment and standalone bungalow segment in the suburbs. The downside risk to the sector are narrow fiscal space, high debt levels, tight credit conditions and liquidity on the international market and lack of consensus on political issues including Governance and reforms, taxes and public spending may slowdown growth in the second half of 2025 and 2026. Additionally, tightening of lending standards by banks slows down lending, thus impacting not -only completion of projection but also financial sector stability.

The performance of the economy affects income for households and firms, ability to meet their financial obligation and to utilise financial products and services. The

contraction of the economy by 0.7 percentage point in 2024 reduced household wellbeing, financial health and contributed the increase in non-performing loans. As a result, lenders reduced lending and tightened lending standards. The slow growth amid increased uptake of financial services slows down growth in incomes for households and firms, which increases indebtedness and reduces financial health. The increase in household and firm financial fragility can cascade in the financial sector undermining financial intermediation. Fragility in the financial sector not only drives people to poverty but also stifle their effort to improve their living conditions and participate in the financial sector. **Box I** below analyses the link between financial inclusion and financial stability. Whereas financial inclusion is critical in promoting access and usage of quality and affordable financial services that match consumer needs, it may at times trigger unintended consequences such as poor asset quality on account of non-performing loans and debt distress thus disrupting the stability of the financial system. This may also be manifested by the decline in financial health.

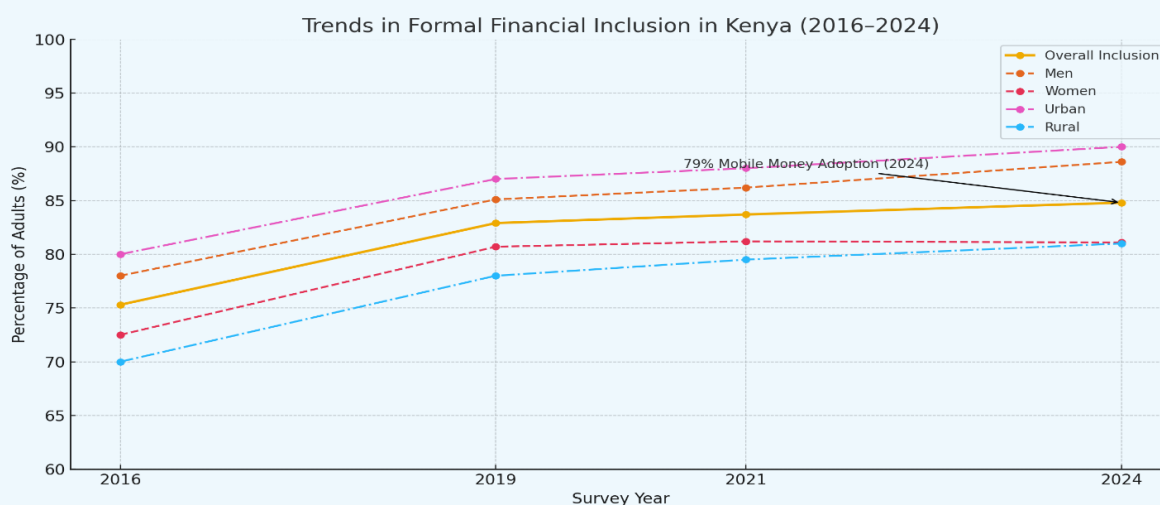
Box 1: Financial Inclusion and Financial Stability Nexus

Financial Inclusion and Indebtedness in Kenya: Evidence from the FinAccess Household Survey 2024

In the advent of mobile money in 2007, Kenya has made significant progress in expanding access to financial services. According to the FinAccess Household Survey (2024), financial inclusion reached 84.8%, rising from 75.3% in 2016. The primary drivers of this growth are mobile money services, agency banking, and fintech platforms, with mobile money alone accounting for 79% usage among adults. Traditional institutions like banks, MFIs, and SACCOs have also broadened their reach through digital and alternative delivery channels. This progress, underpinned by forward-looking regulatory and policy frameworks, has brought financial services within reach for most of the population. However, indebtedness is increasing, while financial health is declining.

Disparities also persist across gender, geography, and socio-economic groups. For instance, while 88.6% of men are financially included, only 81.1% of women report the same. Urban residents have higher access levels (90%) compared to rural dwellers (81%). These differences underscore the importance of targeted interventions to ensure equitable inclusion.

Figure i: Trends in Formal Financial Inclusion

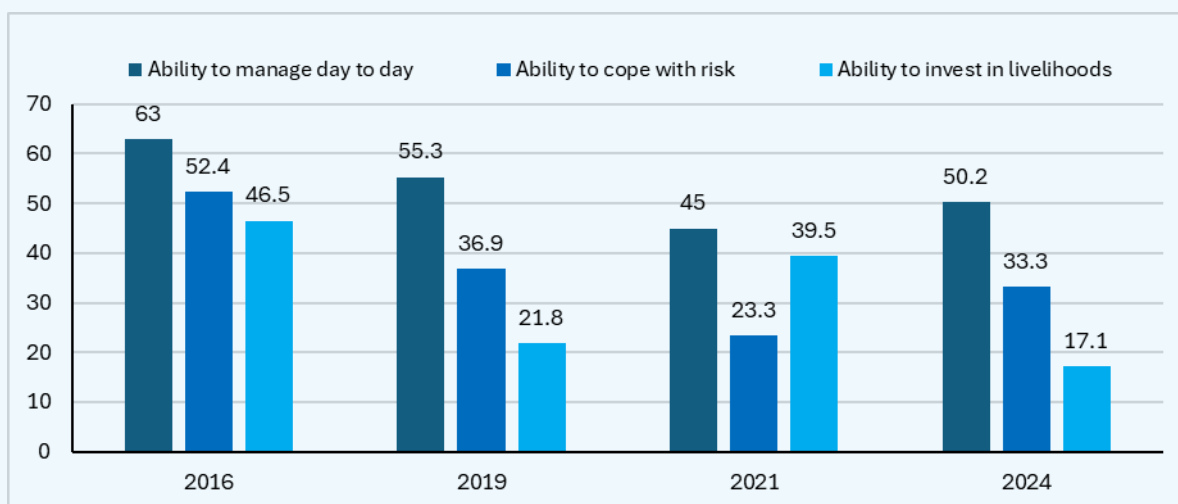


Source: FinAccess Survey

Figure 1 shows that despite the increase in formal financial inclusion in 2024, gender gaps in inclusion between male and female persisted even as that of urban and rural households reduced. Notable also, the 2024 FinAccess Survey showed that 18.3% of adults were financially healthy, marking a significant decline from 39.4% in 2016. This deterioration is attributed to rising indebtedness, low financial literacy, and limited shock-absorption capacity.

The Central Bank of Kenya's Multidimensional Financial Health Index (MFHI) measures financial well-being based on day-to-day financial management, resilience to shocks, and investing for the future. The analysis indicates that only 24.5% of adults could access emergency funds within three days, while 15.1% were saving for retirement. This implies that about 84 percent of the adults are not saving for the future, which exposes them to future poverty, lower welfare and vulnerability to shocks.

Figure ii: Financial Health (Percent)



Source: FinAccess Survey

The adults aged between 26-35 are engaged in income generating activities, are educated and financially literate, which enables them to raise money to manage day to day need, cope with risks and invest in the future more effectively compared to 18-25, 36-45 and above 55 age groups. As a result, 23.9 percent of the 26-35 age group is the most financially health, compare to 14.9 percent, 18.9 percent and 13.4 percent for 18-25, 36-45 and above 55 age groups, respectively.

In rural and urban areas 12.8 percent and 25.9 percent of the adults are financial healthy. The incomes in rural areas are lower, there are fewer financial services to manage liquidity and to invest in the future, this reduces the capacity of rural residents in Kenya to meet their daily need, raise money to cater for shocks and to invest in the future. Conversely, in urban areas, there is diverse financial services that individual can rely on to meet their daily needs, save and invest for the future and mitigate shocks. Incomes in urban areas are relatively stable due to formal employment, stable income generated from business as well as follow of remittance, which enhances financial health. Therefore, strengthening livelihoods and scaling up access and utilisation of financial services, enhancing financial literacy and empowerment in rural areas contribute to improving financial health.

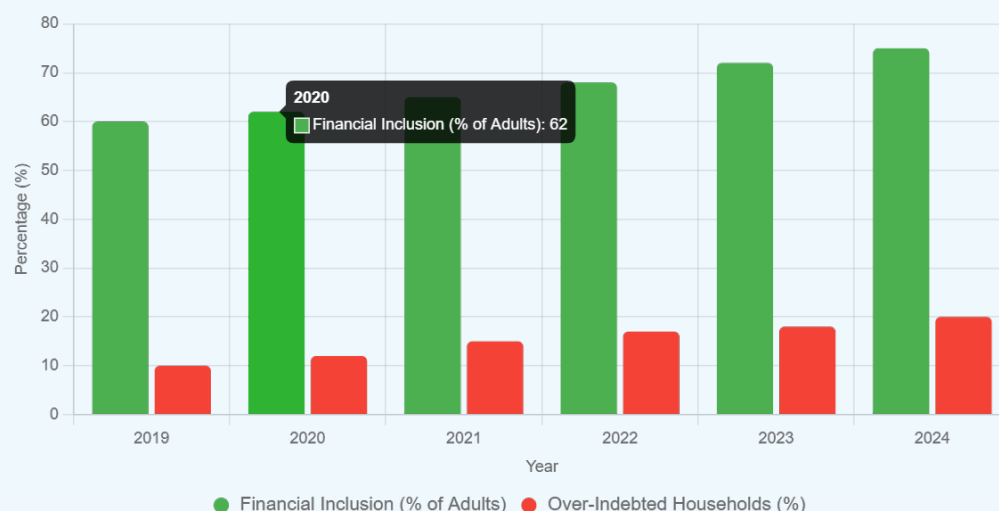
Indebtedness and Risk of Default

The COVID-19 pandemic, tightening fiscal constraint that reduced the capacity of Government to support growth and vulnerable firms and households, tight monetary policy to stem inflation and slow structural transformation of the economy reduced employment opportunities, elevated poverty and debt distress. The micro small and medium sized enterprises employing between 60 percent to 70 percent of labour were severely affected the shocks, contributing to the deterioration in financial health and debt distress.

Besides economic performance, irresponsible borrowing and predatory lending also accentuate debt distress. The gains in financial inclusion increased access and utilisation of credit, while innovations leveraging on mobile money have enabled lenders to provide digital loans and other loans using transaction and communication data to identify and vet borrowers as well as designing loan products. However, digital loans are expensive, short term, and not appropriate for long term investment, which has a significant impact on income. Borrowers also may borrow without fully understanding loan

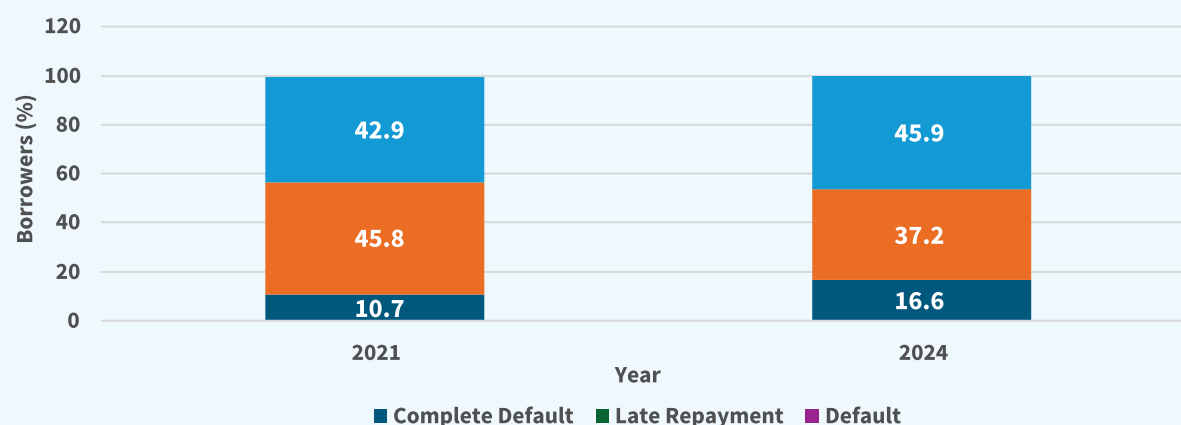
terms and conditions or repayment obligations. In addition, lenders may extend credit in manner that creates dependency and traps borrowers in debt, which is not sustainable for borrower and lenders. The unsustainable borrowing and lending undermine financial soundness of households, firms and financial services providers.

Figure iii: The relationship between Financial Inclusion and indebtedness



The 2024 FinAccess Household survey indicates that 16.6 percent of borrowers defaulted, compared to 10.7 percent in 2021, while late repayments decreased from 45.8 percent to 37.2 percent. Households are also coping with debt distress by reducing consumption, using savings, or taking on additional loans. These strategies reduce welfare and increase financial fragility. In figure iii, the proportion of individuals who defaulted increased in the 2024 survey compared to the 2021 survey.

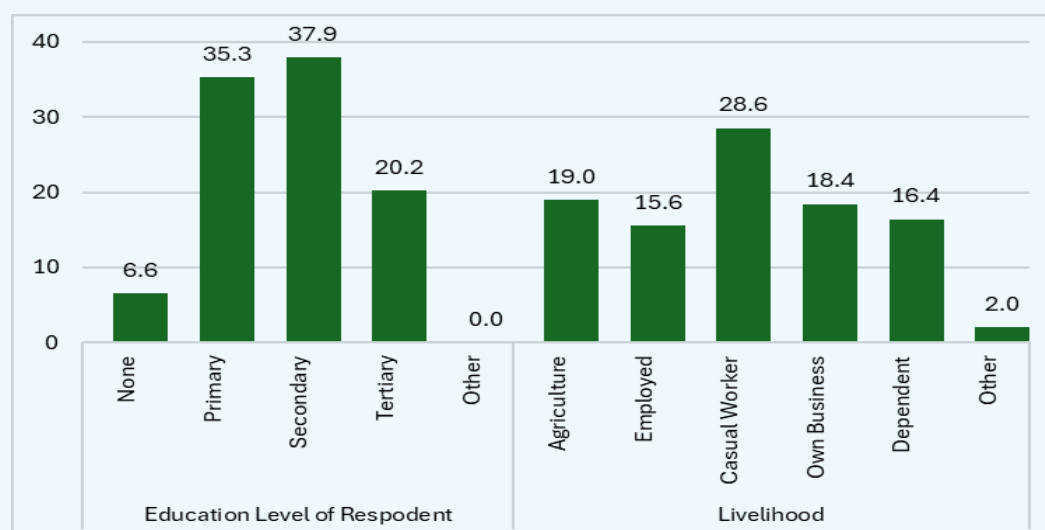
Figure iv: Debt Distress Trends (2021 vs. 2024)



Source: 2024 FinAccess Survey

Fluctuation in income for rural residents reduces their ability to meet their loan obligation. As result, 42.8 percent of the rural residents defaulted compared to 56.2 percent of the urban residents. Hustler fund in the mots defaulted loan product by 50.9 percent of the rural resident, compared to 62.2 percent among urban residents. Hustler fund loans are the most defaulted followed by shop keeper credit. This can be attributed to the perception that hustler fund is a government fund, which should not be repaid. The shopkeeper credit is second most defaulted credit product. Fluctuations in income undermine efforts of workers and business to synchronise loan repayment, with saving and earnings. This increases chances of loan default. Causal workers experience fluctuation income and hence, the largest proportion of them (28.6 percent) are defaulted compared to the employed, business dependants and those engaged in the agriculture sector. A larger proportion of Individuals with primary and secondary education also defaulted compared to individuals without education and with secondary education

Figure v: Debt Distress livelihood and level of education (Percent)



During economic slow own, individual in the highest wealth quintile default due to difficulties in liquidating assets decline in economic activity, which reduces sales and delays in payments. In the 2024 FinAccess Household Survey, 22.9 percent and 22.0 percent individual in the fourth and fifth, respectively defaulted.

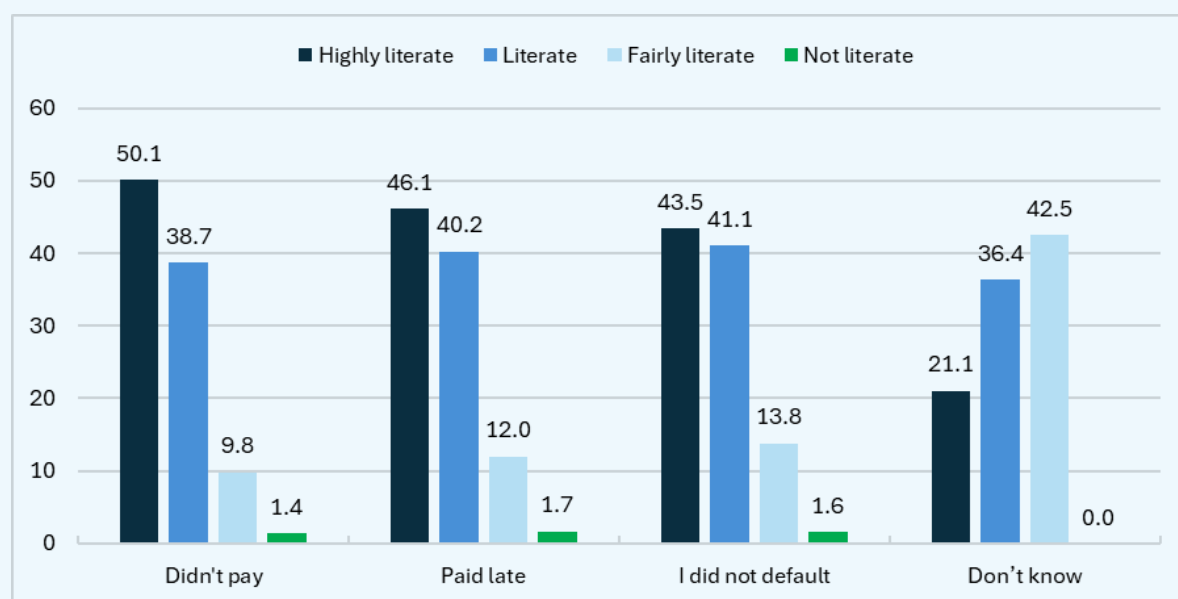
More importantly, individual in debt distress have a higher probability of default. In the 2024 FinAccess Survey, 80.4 percent of the financially unhealth defaulted. The financial unhealthy face binding financial constraint, have difficulties managing financial shocks and have not accumulated assets to dispose to meet their loan obligations.

Financial literacy is vital for inclusive finance, mitigating debt distress and improving financial health, yet it remains low. The FinAccess 2024 Survey reveals modest gains, with adult literacy rising from 38.4% in 2021 to 41.6% in 2024.

Financial literacy gap is even more acute among youth, women, and rural populations with 45.8% of men are financially literate versus 38.3% of women. Higher literacy is linked with better financial behaviours, including budgeting, emergency savings, and timely debt repayment. Financial literacy also contributes to improvement in financial health and reduce debt distress, financial exclusion and

vulnerability. The 2024 FinAccess Survey, indicate that 43.5 percent and 41.1 percent of the respondent who were highly financially literate and financially literate, respectively did not default. In addition, 21.1 percent a36.4 percent and 42.5 percent of the highly financially literate, financially literate and fairly financially literate, did not know that their loans were due for repayment, respectively. The implication this results is that, financial literacy contributes to reducing loan delinquency among borrowers.

Figure vi: Debt Distress and financial literacy (Percent)



s in However, borrowing decisions and meeting loan obligations are influenced awareness of cost of credit, financing gap, expected cash flows, behavioural factors influenced by terms and conditions of credit and economic performance. About 50.1 percent of the respondents who are highly financially literate did not repay their loans, compared to 38.7 percent, 9.8 percent and 1.4 percent of the literate, literate and illiterate. Addition, 46.1 percent and 40.2 percent of the highly literate and literate paid their loans late. This implies that other factors other than financial literacy influenced loan default or late loan repayments.

Therefore, whereas enhancing financial literacy will contribute towards uptake of financial services, enhance responsible borrowing and sustainable lending, policies that promote growth increase income and capacity to repay loans. The proposed National Financial Inclusion Strategy (NFIS 2025–2028) prioritizes financial capability. It proposes integrating financial education in schools, developing digital learning resources, supporting national campaigns like Global Money Week, and targeting special groups such as MSMEs and forcibly displaced persons.

Regulators have also strengthened consumer protection to support inclusive finance. The CBK, IRA, RBA, SASRA, and CMA have introduced measures such as licensing digital lenders, improving disclosure practices, and enhancing complaints management.

Government social protection programs like the Hustler Fund and Inua Jamii offer crucial support to vulnerable groups. However, challenges persist in targeting and delivery effectiveness. Additionally, the Kenya Deposit Insurance Corporation (KDIC) continues to safeguard public confidence through the Deposit Insurance Scheme, which protects depositors' funds. The NFIS 2025–2028 offers a comprehensive framework for enhancing financial inclusion and health. It is aligned with Vision 2030 and SDG objectives and emphasizes data collection, performance monitoring, and policy coherence. Stakeholders such as FSD Kenya, KBA, and AMFI contribute by fostering private-sector cooperation and promoting inclusive financial practices, including the collection of sex-disaggregated data to support gender-sensitive interventions.

2. FINANCIAL SECTOR DEVELOPMENTS AND RISKS OUTLOOK

This chapter analyses performance, policy developments, risks and outlook for banking, capital markets, insurance, pensions and Savings and Credit Cooperatives (SACCOs) sectors in the period to 2024 and first half of 2025. These sectors are licensed, regulated and supervised by the CBK, CMA, IRA, RBA and SASRA, respectively. In 2024, and first half of 2025, various policy measures and other interventions ensured that the sector remains resilient to legacy and new shocks.

Kenya's financial sector has undergone significant transformation in terms of size, sophistication and interconnectedness. While financial soundness indicators for banks, SACCOs, insurance and pension funds have improved, the indicators for microfinance banks and capital markets have deteriorated. The Microfinance banks incurred losses for six consecutive years, while equity prices declined (**Table 2**).

Table 2: Select Indicators for the Financial Sector

		Dec-19	Dec-20	Dec-21	Dec-22	Dec-23	Dec-24
Banking sector	Total Assets (KSh Mln)	4,832.3	5,420.1	6,008.0	6,537.4	7,690.7	7,568.0
	PBT (KSh Mln)	159.9	112.8	195.4	240.4	219.3	260.3
	Non-Performing Loans (KSh Mln)	333.4	424.1	426.8	503.2	641.3	697.3
	Core capital (KSh Mln)	639.1	692.5	757.3	809.1	893.6	989.2
SACCOs	Total Assets (KSh Mln)	555.9	630.9	700.3	764.2	981.5	1,080.9
	Gross Income (KSh Mln)	80.2	84.5	96.5	105.6	140.9	159.6
	Non-Performing Loans (KSh Mln)	25.9	32.9	35.4	48.4	44.4	53.1
	Core capital (KSh Mln)	95.1	100.4	119.6	142.3	162.3	188.7
Insurance	Assets (KSh Mln)	705.8	761.3	845.8	943.7	1,063.8	1,237.4
	Profit Before Tax (KSh Mln)	16.1	12.8	8.8	14.2	27.5	41.7
	Equity (KSh Mln)	163.9	169.2	173.1	186.6	202.6	239.8
Pension	Total Assets (KSh Mln)	1,298.2	1,399.0	1,547.4	1,576.2	1,725.4	2,255.3
	Overall Risk	3.1	3.2	3.0	3.0	2.9	2.7
Microfinance Banks	Total Assets (KSh Mln)	77.2	75.4	75.1	70.4	64.2	57.9
	PBT (KSh Mln)	(0.2)	(2.9)	(0.7)	(1.0)	(2.4)	(3.5)
	Non-Performing Loans (KSh Mln)	10.0	13.4	12.9	14.2	11.9	11.9
	Core capital (KSh Mln)	9.0	5.8	6.5	6.8	4.6	2,713.5
NSE	NASI Points (End Period)	166.4	152.1	166.5	127.5	92.1	123.5
	NSE 20 Points (End Period)	2,654.4	1,868.4	1,902.6	1,676.1	1,501.2	2,010.7
	Market Capitalization KSh Bns	2,540.0	2,336.7	2,592.9	1,986.1	1,439.0	1,939.7
	Equity Turnover KSh Bns	153.8	148.7	137.4	94.3	88.2	106.0
	Foreign Purchase (KSh Bns)	106.7	81.5	72.7	38.8	26.6	44.7
	Foreign Sales (KSh Bns)	105.3	110.1	82.9	63.2	47.9	61.2
	Ave. Foreign Investor Participation to Equity Turnover (%)	68.5	64.7	57.1	54.2	48.0	50.9
	Total Bond Turnover KSh Bns	651.7	691.8	957.0	741.8	644.0	1,544.4

Source: CBK, CMA, IRA, RBA and SASRA

2.1 Banking Sector

Kenya had thirty-eight (38) commercial banks, one (1) mortgage finance company and fourteen (14) deposit taking microfinance banks (MFBs) in 2024 and the first half of 2025, all regulated by the Central Bank of Kenya. Following, the enactment on licensing and regulating digital credit providers (DCPs), the DCPs licensed by the CBK have increased from 52 DCPs in mid-2024, 85 DCPs in the First Half of 2025. Other institutions regulated by the CBK include credit reference bureaus, Foreign Exchange Bureaus, money remittance providers, representative offices of foreign banks and mortgage refinance companies. In 2024, the banking sector remained stable and resilient to shocks both with and without. Despite monetary policy easing, lending is yet to fully recover as asset quality continue to deteriorate as banks continue to tighten lending due to prevailing risk premia as result of challenging macroeconomic environment. Downside risks to the sector's stability remains, including elevated credit risks operational risk related to cybercrimes.

2.1.1 Commercial Banks and Mortgage Finance Companies

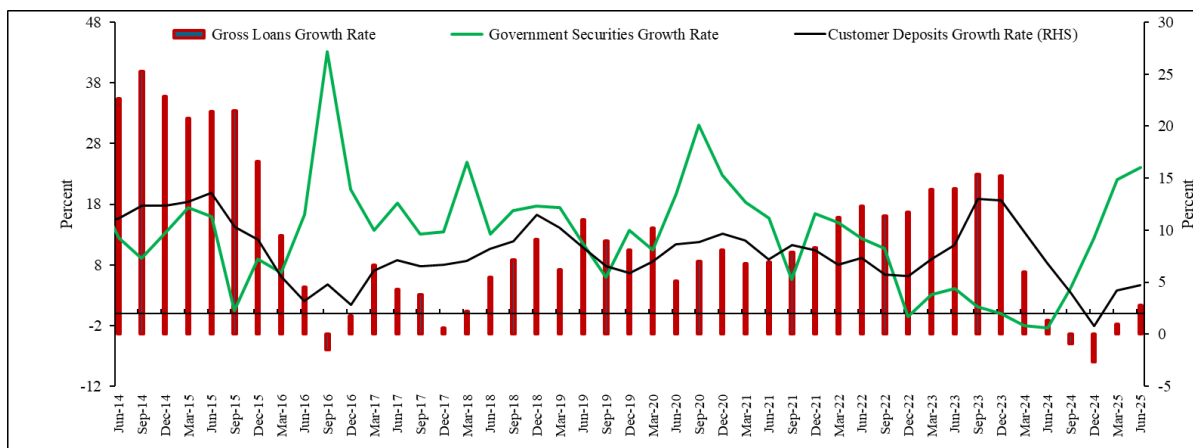
The banking sector was characterised by strong capital and liquidity buffers enabling it to withstand elevated market and credit risks in 2024. The sector's core and total capital increased from KSh 893.63 billion and KSh 1,075.80 billion in December 2023, to KSh 989.2

billion and KSh 1,118.7 billion, respectively, in December 2024. The ratio of Core Capital and Total Capital to Total Risk Weighted Assets (TRWA) stood at 18.6 percent and 19.6 percent in December 2024, compared with 15.4 percent and 18.6 percent reported in December 2024, respectively. The increase in the ratios reflect a continued build-up in capital mainly attributed to increase in earnings and banks building there core capital to the required minimum following Ksh. 3 billion by December 2025. The ratios were well above the minimum statutory core and total capital requirement of 10.5 percent and 14.5 percent, respectively, implying that banks have adequate capital buffers to absorb emerging and legacy shocks to sustain lending.

The total net assets¹ of banks contracted by 1.6 percent, from KSh 7,690.7 billion in December 2023 to KSh 7,568.0 billion in December 2024 (**Figure 16**). The main driver to the contraction in net total assets of banks was the decrease in net loans and advances, which accounted for 48.1 percent of the total net assets in 2024. The net loans and advances decreased by 2.7 percent in 2024 compared to 2023. The decrease in loans and advances is on account of tight lending standards.

¹ Refers to loans and advances to customers net off provisions

Figure 16: Balance Sheet Growth Dynamics (percent)

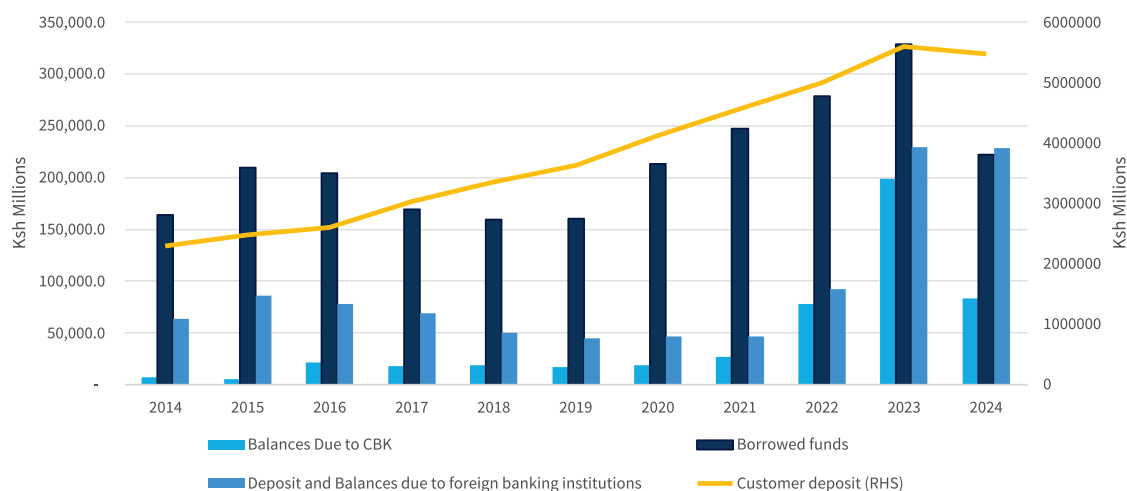


Source: CBK

Balances due from institutions abroad, decreased from KSh 516.2 billion in 2023 to KSh 380.24 billion in 2024, due to appreciation of the Kenya Shiling against the USA Dollar. These counterbalanced the 12.3 percent increase in banks' exposure to government securities that increased from KSh 2,114.75 billion in 2024 from KSh 1,882.9 billion in 2023.

Decline in aggregate liabilities was mainly on account decreases in balances due to Central Bank, deposits and balances due to local banking institutions, borrowed funds and customers deposits, which accounted for 92.2 percent of total liabilities (**Figure 17**). The customer deposit, which constitute a key funding base for assets decreased by 2.1 percent from KSh 5,595.8 billion in December 2023 to KSh 5,480.8 billion in December 2023.

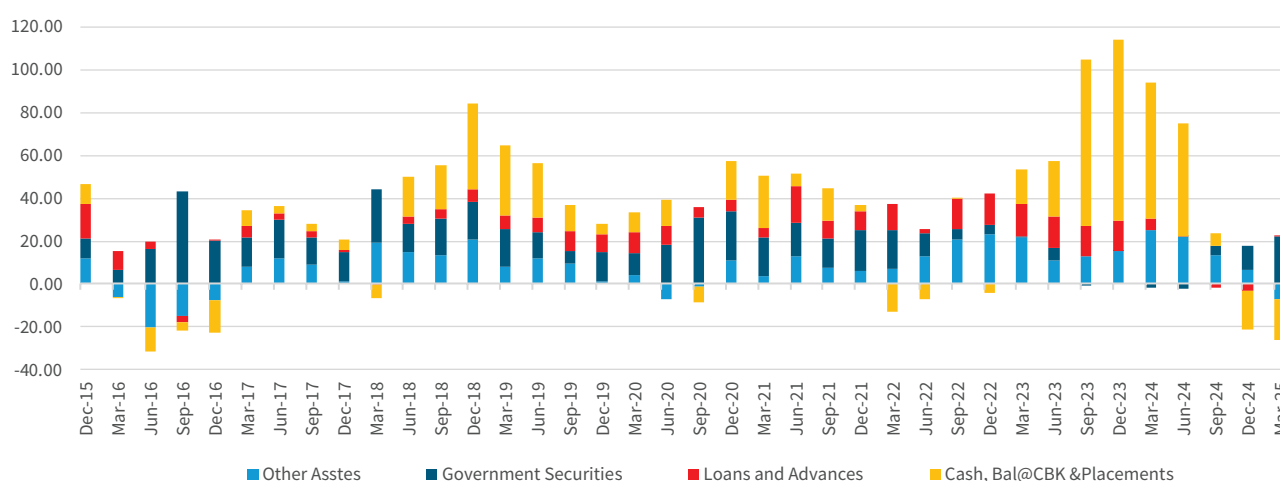
Figure 17: Trends in Banking Sector Funding Sources



Source: published audited bank data

Assets composition of the banking sector has evolved in the recent past reflecting policy and other shocks that impacted the economy and the sector (**Figure 18**). Prior to the COVID-19 pandemic, banks faced two major shocks; the 2015-16 stress² that led to the regulator's intervention with 'New Normal' policy measures to restore stability and a parliamentary legislation that introduced Interest Rates Capping law in 2016 but later repealed in November 2019 after its undesired consequences. During this period, invested in government securities and cut down on lending to minimize losses arising from capped interest rates.

Figure 18: Assets Decomposition by Growth Rates (percent)



Source: CBK Staff computation from published financial statements.

The repeal of Interest Rates Capping Law in November 2019 led to recovery in lending to the private sector as banks embarked on implementing their risk-based credit pricing models after obtaining approval by the Central Bank. The models are part of the core pillars of Banking Sector Charter, other pillars of the banking sector charter were focus on customer-centricity, which prioritised transparency in credit pricing. The onset of COVID-19 outbreak elevated credit risks, which banks responded by increasing investment in government securities. However, increase in public sector indebtedness and interest rate as result of monetary policy tightening to stem inflationary pressures in 2022-2024, saw banks reduce holding of government securities to minimise mark-to-market valuation losses from bond repricing. Banks also increased loans and advances to capitalise on higher lending rates and sticky deposit rate.

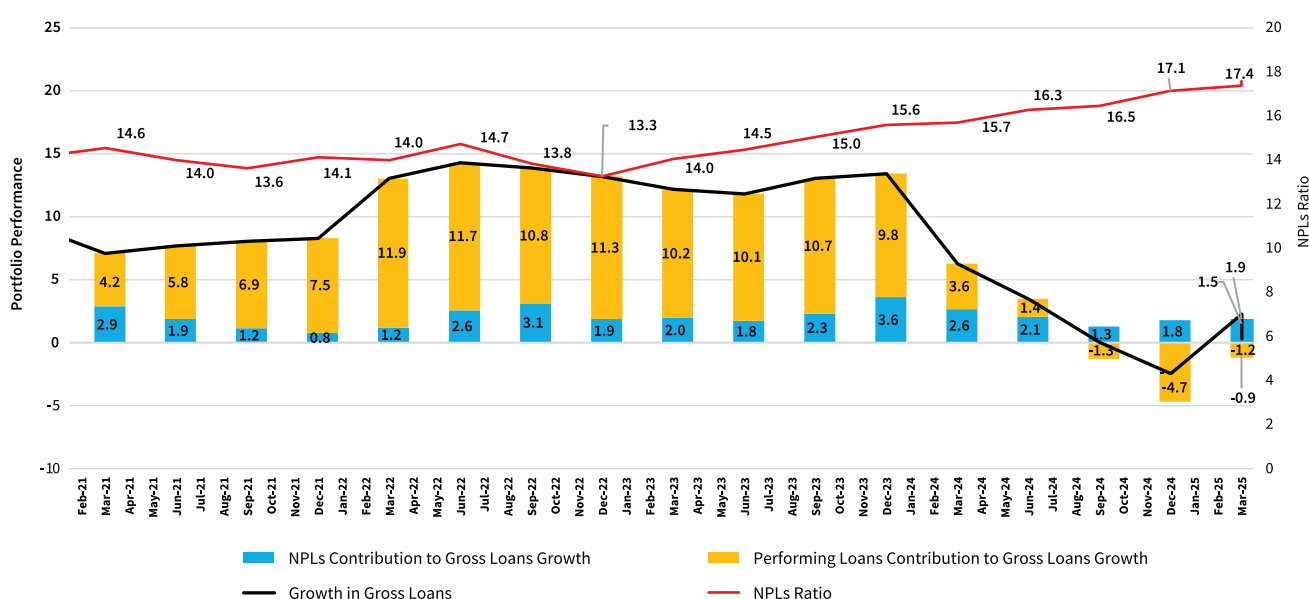
However, monetary policy tightening, lack of fiscal policy stimuli to the economy slowed down the economy, which reduced incomes and capacity of households and firms to borrow. As a result, NPLs increased, and banks tightened lending standards to mitigate credit risk. The ratio of non-performing loans to gross loans (NPLs) increased 15.6 percent in December 2023 to 17.1 percent

² Characterized by collapse of Dubai Bank, Imperial Bank and Chase Bank between September 2015 and April 2016.

in December 2024. The contribution of performing loans to overall growth in gross loans contracted to 4.7 percent in 2024 from a contribution of 9.8 percent 2023 indicating slow growth in new loans. this is reflected in the reduction of overall gross loans in 2024..

The slow growth rate of performing loans is as a result of tight financial conditions, decline in the capacity of firms and households to borrow and repay, high interest rate, delayed payments by public sector and unconducive business environment (**Figure 19**).

Figure 19: Loans Growth by Contributions



Source: CBK 2023 Banking Sector Credit Risk Stress Test

Whereas NPLs ratio in 2024 and first half of 2025 is the highest, the growth in NPLs in the period under review is lower compared to the growth levels in the period leading to and during the 2015-16 banking sector instability. The NPLs grew by an average of 36.7 percent

from 2013 to 2016, with a peak of 52.8 percent in 2016 at the height of banking sector instability. The NPLs growth rate of 29.5 percent in 12 months to December 2023 and 14.1 percent in 12 months to June 2024, is lower than the 2016 level (**Table 3**).

Table 3: NPLs annual Growth Rates

	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	Dec-23	Dec-24
Gross Goans (KSh Bln)	1,605.2	1,972.1	2,299.1	2,340.0	2,353.3	2,567.3	2,774.6	2,999.5	3,248.7	3,630.3	4,183.4	4,070.2
Gross NPLs (KSh Bln)	80.6	107.1	139.4	212.9	252.6	308.8	333.4	424.1	426.8	503.2	651.8	697.3
Gross loans Growth (%)	17.9	22.9	16.6	1.8	0.6	9.1	8.1	8.1	8.3	11.7	15.2	(2.7)
Gross NPLs Growth (%)	30.9	32.9	30.1	52.8	18.7	22.2	8.0	27.2	0.6	17.9	29.5	7.0
NPLs Ratio (%)	5.0	5.4	6.1	9.1	10.7	12.0	12.0	14.1	13.1	13.9	15.6	17.1

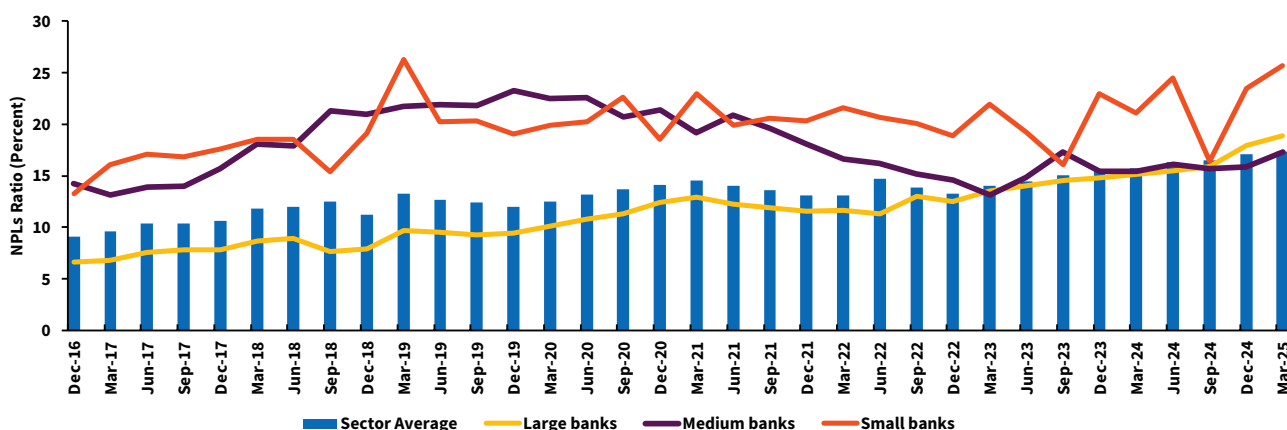
Source: CBK

Kenya's banking sector is categorized into small (Tier III), medium (Tier II) and large (Tier I) peer groups in terms of their market share.

As of December 2024, there were 22 banks in small peer group, 8 banks in medium peer group and 9 banks in large peer group. In terms of combined weighted market share, the Tier I banks accounted for 75.6 percent, Tier II banks accounted for 16.7 percent while Tier III banks accounted for 7.7 percent in 2024.

In terms of total net assets, Tier I banks accounted for 75.5 percent, Tier II banks accounted for 16.4 percent while Tier III banks

accounted for 8.1 percent in 2024. These differences also reflect the heterogeneity of assets quality. As of December 2024, banks in the small peer group had the recorded the highest average in NPLs ratio from 23.4 December 2024percent from 22.9 percent in December 2023. Banks in Tier II had the lowest average NPLs ratio of 15.9 percent in December 2024 a slight increase from 15.4 percent in December 2023. Banks in large and small peer group saw their NPLs ratio above the sector's average of 17.1 percent in December 2024, with the trend continued in March 2025 (**Figure 20**).

Figure 20: NPLs ratio by bank peer groups

Source: CBK staff computation

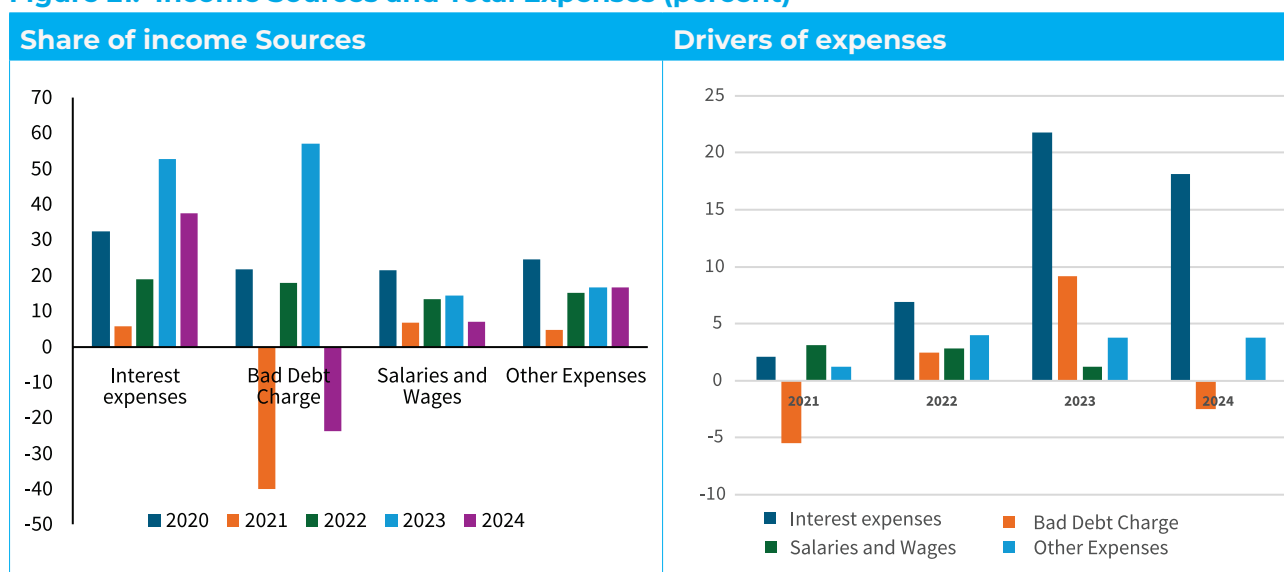
Growth in NPLs was mainly driven by Real Estate, Trade, Building and Construction, Transport & Communication and Personal/household sectors. In terms of the share of total NPLs of KSh 697.29 billion, Tier I banks accounted for 73.73 percent, Tier II banks accounted for 12.17 percent while Tier III banks accounted for 14.10 percent in 2024. The economic recovery, implementation of programmes under bottom-up economic transformation, easing of monetary policy and prudence in lending are expected to moderate NPLs growth. The downside risks, including fiscal consolidation and other fiscal challenges may elevate NPLs in the remainder of 2024.

Despite the increase in NPLs ratio, banking sector profit before taxes, capital and reserves increased which can be used as buffers against credit risks. For instance, banks in the large peer group had the highest proportion of PBT and Capital and reserves, accounting for 89.26 percent and 75.0 percent of the total KSh 260.3 billion and KSh 1,183.64 billion, respectively in December 2024. Although banks in Tier II and Tier III had low PBT of KSh 26.6 billion (10.2 percent) and KSh 1.3 billion (0.5 percent), their capital and reserves of KSh 194.15 billion (16.40 percent) and KSh 102.20 billion (8.63 percent), respectively are adequate to cover the NPLs and enable banks to continue lending. In addition, the ratio of specific provisioning to

NPLs (coverage ratio) for large peer groups increased to 47.1 percent from 44.4 percent in December 2023, due to increase in earnings, while coverage ratio for medium and small peer groups decreased to 47.6 percent and 33.1 percent in December 2024 from 49.0 and 37.0 percent in December 2023 reflecting decline in earnings. Therefore, banks in the small and medium peer groups need to increase their provisions in tandem with the evolving credit risks, conduct robust credit risk assessment, implement risk-based pricing, diversifying loan portfolios, utilizing collateral and guarantees, and establishing strong credit risk policies to mitigate and manage credit risk (**Figure 21**).

Despite the deterioration of assets quality, the reduction in bad debt charge mainly contributed to the increase in Profits before tax in 2024. This indicates that the banking sector focussed more on loan recoveries and tightened lending standard to mitigate credit risk. Indeed loan recoveries increased from KSh 4.7 billion to KSh 5.2 billion, while write off decreased from KSh 33.3 billion to KSh 7.0 billion in 2024. As a result, profits before tax increased by 18.71 percent in 2024 to KSh 260.3 billion, from KSh. 219.3 billion in December 2023.

Figure 21: Income Sources and Total Expenses (percent)



Source: CBK

Consequently, Return on Assets (ROA) increased from 2.9 percent in December 2023 to 3.4 percent in December 2024. However, Return on Equity (ROE) decreased from 22.4 percent, in December 2023, to 22.0 in December 2024 as a result of increase in reserves. The increase in profitability contributed to the build-up in

capital of 20.7 percent, from KSh 980.9 billion in December 2023 to KSh 1,183.56 billion in December 2024 (**Table 4**). This increases the sector's ability to set aside sufficient provisions and build core capital KSh 3 billion in required in December 2025 and KSh 10 billion in 2029.

Table 4: Profitability of the banking sector

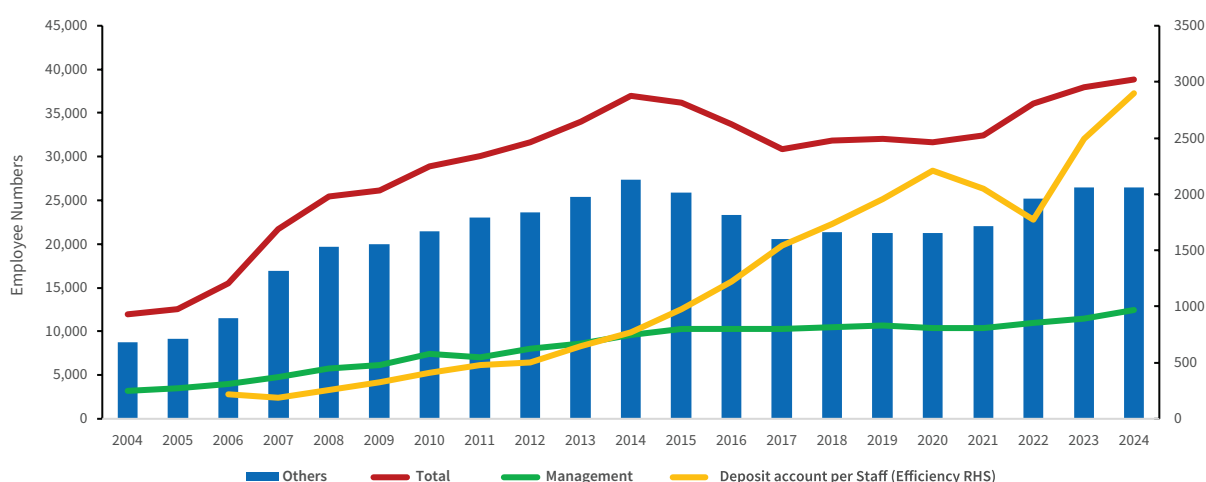
		2019	2020	2021	2022	2023	2024	Percentage Change 2023-2024
All Banks (39)	PBT (Ksh.Bln)	159.1	112.1	112.1	240.4	219.3	260.3	18.71
	ROA (%)	2.5	2.1	2.1	3.7	2.9	3.4	0.59
	ROE (%)	21.2	13.9	13.9	26.3	22.4	22.0	-0.39
Large Banks(9)	PBT (Ksh.Bln)	142.9	97.5	97.5	208.3	185.6	232.4	25.17
	ROA (%)	4.0	2.4	2.4	4.2	3.1	4.1	0.93
	ROE (%)	26.5	16.3	16.3	30.6	25.3	26.2	0.84
Medium Banks (8)	PBT (Ksh.Bln)	18.3	17.2	17.2	29.2	29.9	26.6	-11.00
	ROA (%)	2.3	1.9	1.9	2.8	2.7	2.3	-0.39
	ROE (%)	14.1	12.2	12.2	19.6	19.0	13.7	-5.26
Small Banks (21)	PBT (Ksh.Bln)	-2.1	-2.5	-2.5	2.9	3.7	1.3	-64.49
	ROA (%)	-0.5	-0.5	-0.5	0.5	0.6	0.2	-0.39
	ROE (%)	-3.4	-3.7	-3.7	3.4	4.2	1.3	-2.87

Note: ROA & ROE changes are in percentage points

Source: CBK

The banking sector continued to leverage on technology to enhance efficiency in service delivery and manage operational costs but has come with risks too (Figure 22). The adoption technology in banking sector such as mobile money continues to moderate employment. The number of deposits increased relative to number of staff, while growth staff emoluments declined 14.3 percent in 2023 to 6.9 percent in 2024. The decline in staff emolument and adopt of technology reduced operational cost

Figure 22: Categories of staff and deposit per staff in the Banking sector



Source: CBK

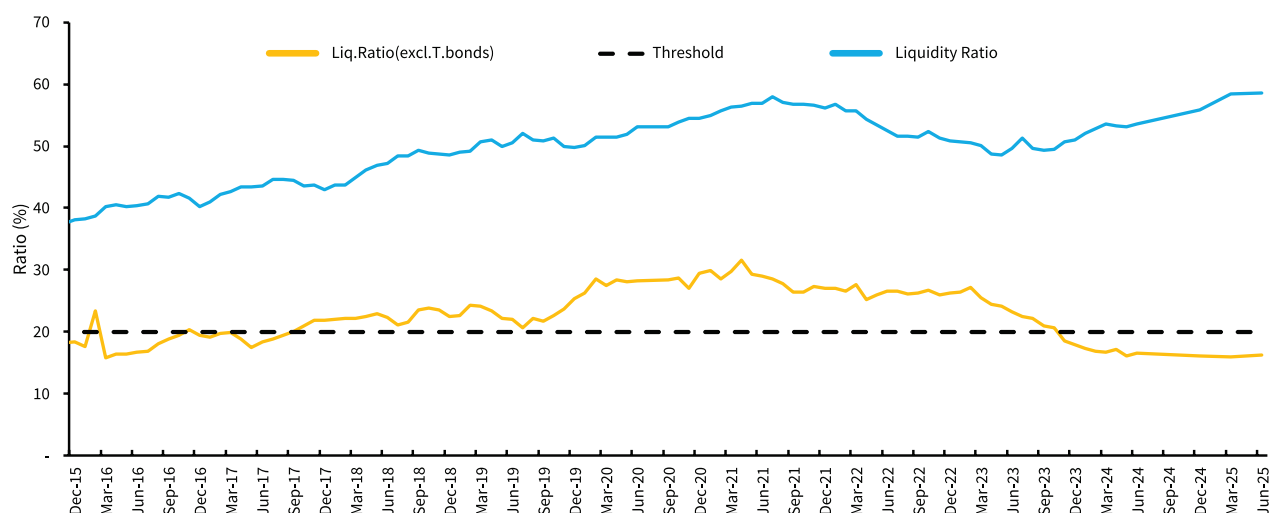
While technology adoption has increased efficiency in the delivery of banking services, it has elevated risk to the financial stability. Cyber risk has risen, with cybercriminals becoming increasingly sophisticated, using a variety of techniques to infiltrate banking and payment systems. The number of cyber threats, amount exposed and amount lost more than doubled between 2023 and 2024. The prevalent use of social media also continues to pose risk to financial stability through rapid spread of rumours and misinformation, which reduces confidence in the financial system.

An important metric for assessing banking sector soundness and stability is the ability of banks to settle their maturing obligations always falling due without difficulties (liquidity ratio) as measured against the 20 percent minimum regulatory requirement.

Other measures being used globally, and Kenya is in the final stages of implementing them are liquidity coverage ratio (LCR) and Net Stable Funding Ration (NSFR). Overall, liquidity ratio for the sector averaged 55.8 percent in December 2024, with banks in the medium peer group having the highest liquidity ratios compared with banks in large and small peer

groups. Liquid assets³ increased by 8.17 percent to KSh 3,070.23 billion in December 2024, mainly due to increase in balances with Central Bank of Kenya and investment in treasury bills. The holding of treasury bills increased by 86.2 percent while treasury bonds increased by 6.8 percent in December 2024 (**Figure 23**).

Figure 23: Liquidity Ratios Trends

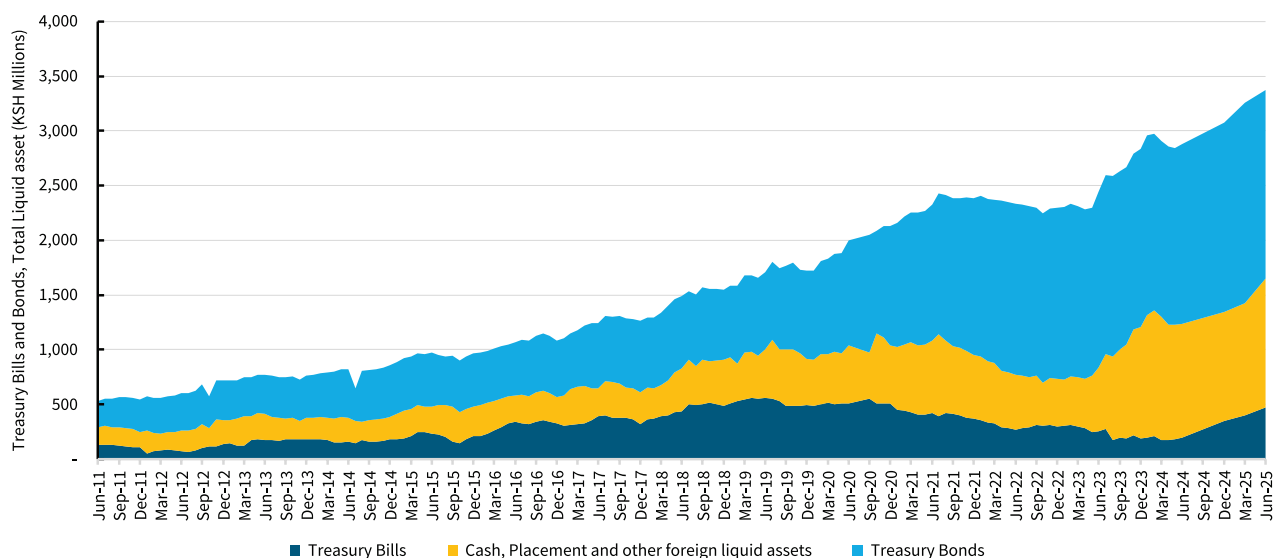


Source: CBK

The share of tradable treasury bonds and bills in liquid asset held by banks increased from 63.8 percent in June 2024, to 65.0 percent in June 2025 (**Figure 24**). This was driven by investment in Government securities as banks tightened their lending standards with the growth in NPLs. Banks also increased cash, placement and foreign liquid assets to cater for their liquidity needs. While the overall liquidity ratio remains way above the 20 percent minimum threshold, excluding treasury bonds from liquid assets reduces the buffer significantly. Therefore, any shock or policy change that impacts treasury bonds as liquid assets, could easily introduce liquidity risks.

³ Liquid assets – notes and coins, balances with central bank of Kenya, balances with domestic commercial bank, balances with banks abroad, balances with financial institutions balances with mortgage finance companies balances with building societies government of Kenya, treasury bills and bonds and foreign treasury bills & bonds

Figure 24: Composition of Liquid Assets



Source: CBK

Despite the banking sector having capital and liquidity buffers, emerging risks necessitate increasing capital and liquidity buffers. In this regard, the CBK in collaboration with The National Treasury is reviewing minimum capital and liquidity. The current minimum core capital is being adjusted from KSh 1 billion to KSh 10 billion by 2029. Whereas, increasing the minimum core capital for banks to KSh 10 billion will enhance stability of the banking sector and enable them to effectively intermediate funds, it has a potential of increasing concentration in the banking sector, which encourages banks to be less innovative. Banks that are not able to raise additional capital, especially with tight financial condition may be forced to merge or be wound up, leaving the niche segments either underserved or excluded in the banking sector. Sectoral concentration has a tendency of increasing cost of financial services and underinvestment in infrastructure. The increase in the cost of

financial services and lack of innovation in the delivery of the services discourage their uptake with possibility of stagnating financial inclusion. The CBK is continuously monitoring the capital increase requirement to avoid unintended consequences to the banking sector.

2.1.2 Microfinance Banks

The performance of microfinance banks (MFBs) deteriorated in 2024, reflecting structuring changes in the financial and lack of innovation to restructure MFB institutions to put them to sustainable and viable path. Total assets declined by 9.8 percent, to KSh.57.9 billion in December 2024, mainly on account of a 16.8 percent decline net loans and advances (Table 5).

Table 5: Select Indicators for MFBs

VARIABLE	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Annual Change (%)
Total Assets (KSh Mn)	56,972	69,465	72,510	67,597	70,754	76,353	74,879	75,138	70,427	64,202	57,893	-9.83
Net Advances/ Loans (KSh Mn)	39,184	45,749	47,047	42,847	44,179	46,651	44,179	40,359	39,334	37,467	31,180	-16.78
Gross NPLs (KSh mn)	2,348	4,264	7,288	9,300	9,891	9,817	12,980	12,895	12,502	11,893	11,868	-0.21
Total Deposits (KSh Mn)	35,862	40,589	40,198	38,916	40,961	43,941	49,356	50,157	46,491	43,863	42,998	-1.97
Borrowings (KSh Mn)	6,994	13,220	16,435	13,413	14,607	14,934	11,340	9,082	9,328	9,193	5,723	-37.75
Capital & Shareholders Funds (KSh Mn)	10,600	11,633	11,622	11,301	10,443	11,177	8,113	9,235	8,752	6,802	4,518	-33.58
Profits/ (Loss) Before Tax (KSh Mn)	1,002	592	-377.0	-622.0	-1437.0	-339.0	-2240.0	(722)	(980)	(2,391)	(3,531)	47.65
ROAs (percent)	2	1.0	-0.5	-0.9	-5.5	-0.4	-3.8	-0.96	-1.39	-3.72	-6.10	-2.37*
ROEs (percent)	10	5.0	-3.2	-5.5	-13.8	-3.0	-36.3	-7.75	-11.20	-35.16	-78.15	-42.99*

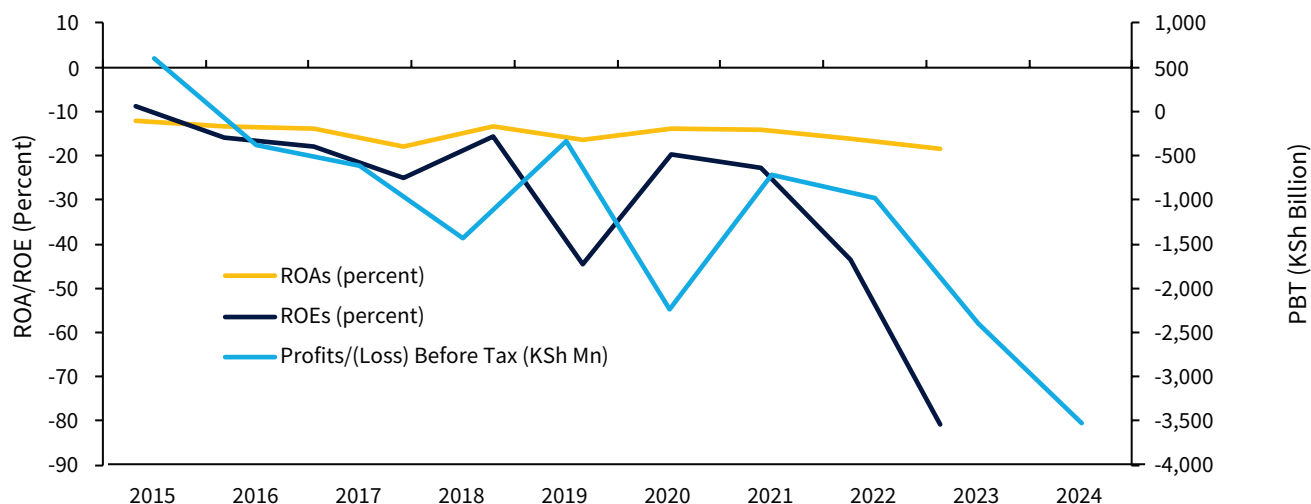
Source: CBK

*Percentage points

Just like on the assets side, the indicators on the liability side point to a more vulnerable subsector. The total deposits declined by 2.0 percent to KSh. 43.0 billion, while borrowing from external sources, declined by 37.8 percent. The decline in the deposits, loans and capital reduced the ability of MFBs to intermediate funds, resulting to increase in the total Loss Before Tax for all MFBs increased to KSh 3.5

billion in December 2024 from KSh.2.4 million in December 2023 impacting ROA and ROE negatively (**Figure 25**). The MFB subsector is highly concentrated. Three of the 14 MFBs account for 87.5 percent of total losses and only three of the recorded profits in 2024.

Figure 25: Profitability for MFBs

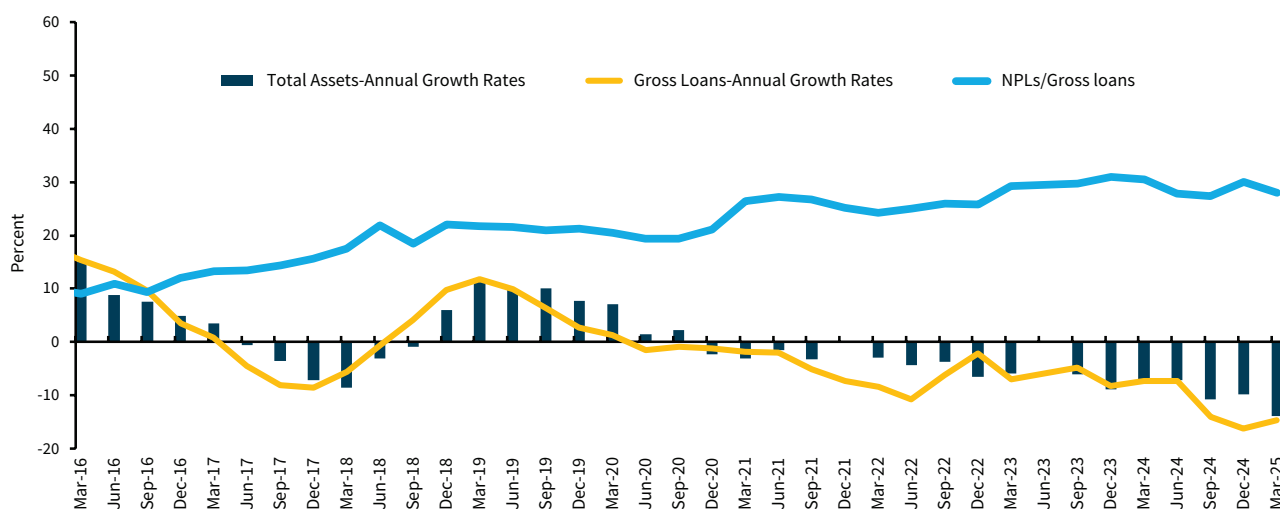


Source: CBK

The increase in losses erodes capital and liquidity buffers, which reduces the ability of MFBs to withstand shocks and to sustain intermediation.

Credit risk remain elevated for MFBs despite the 0.21 percent easing gross NPLs, to KSh 11.87 billion in December 2024 (Figure 26). The MFBs Annual growth in gross loans contracted by 16.2 percent in December 2024 compared with 8.3 percent contraction in December 2023. The low uptake of loans/disbursements further complicates the growth potential of the subsector.

Figure 26: Loans Growth Rate for MFBs



Source: CBK

The outlook for MFBs is even more challenging. This is due to decline in customer deposit, capital, assets and access to external funding. MFBs rely on loans and deposit to finance their assets. With declining deposit, the MFBs face difficulties in accessing loan. In addition, investors evaluate MFBs as risky due to their subdued performance, increase in competition and loss of deposit. The financial sector has also attracted new entrants such as FinTech, telecommunication firms, Government, non-Governmental organisation and development finance institutions in the niche market for MFBs. This has brought competition to MFBs, driving them into losses (**Figure 25**).

The government policies have encouraged competition, innovation, stability and inclusivity in the financial sector. This is to ensure increased use of financial sector. In addition, regulatory requirement to protect personal data and enhance cyber security, require significant investment.

The MFBs subsector require a significant shift in the businesses models such as shift to digital platforms focussing on niche segments of the customers and services. However, MFBs are thinly capitalised to incur such investment or attract strategic investors. Therefore the MFBs can merge or be acquired with or by Banks so that they can leverage on each other's strengths and develop synergies. Consolidation among MFBs presents another viable strategy, which enables the consolidated entity to have a larger deposit and capital base, which can be used as a buffer against shocks and to sustain lending.

On the upside, the consumers are increasingly looking for quality and tailor-made services, which can be provided by MFBs. Hence, sophistication among financial services consumers provides an opportunity for MFBs to serve them, thus improving their viability. However, for MFBs to take advantage of sophistication, they have to change their approach to financial intermediation, innovate and invest in information and communication technology. In addition, as supportive legal and regulatory framework as well as a conducive business environment will catalyse growth, development and stability of the sector.

2.1.3 Digital Credit Providers

The enactment of the Central Bank of Kenya (Amendment) Act, 2021, enabled the CBK to regulate Digital Credit Providers (DCPs). The Central Bank of Kenya (Amendment) Act, 2021 came into effect on December 23, 2021. The primary aim of this legislation is to empower the CBK to supervise and regulate digital lenders, ensuring that they operate in a fair and transparent manner and to catalyse their growth and development. To further solidify this effort, the Digital Credit Providers Regulations were issued on March 18, 2022.

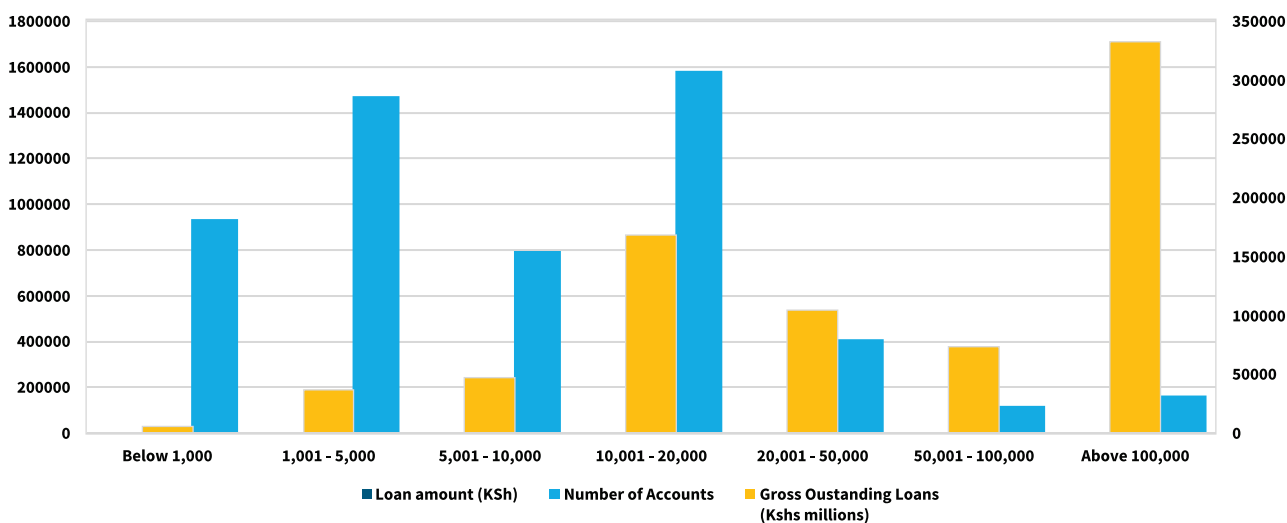
Under these regulations, all previously unregulated digital credit providers were required to apply for a CBK license by September 17, 2022, or cease operations. The regulatory framework not only addresses the urgent concerns around market conduct and consumer protection but also seeks to enhance financial stability in the face of rapid digital expansion. By bringing digital lenders

under formal oversight, the CBK aims to create a more stable, ethical, and transparent credit market that can sustainably support Kenya's evolving financial landscape.

The licensed DCP increased to 126 as at July 2025, with a number of accounts increasing from 2.4 million in December 2023 to 4. Million in December 2024 and 5.5 million in June 2025. The DCP advanced KSh 76.8 billion to the private sector in June 2025 which is more than the outstanding loans advanced by the microfinance banks. the

DCP loans surpassed microfinance bank loans in December 2024. Most of the loans were below KSh 20,000, which are generally of small amounts consistent with DCP model of advancing microloans of maturities ranging between one week and 2 months (**Figure 27**). This can be attributed to DCPs harnessing the full benefits of digitalisation, adopting technology in identifying customers and tailoring products to their needs, leveraging on transactional and communication data to develop credit score for customers and enforce loan obligation which minimises credit risks.

Figure 27: Distribution of DCP loan in June 2025



Source: CBK

The short tenure of loans makes them relevant for meeting emergency needs and working capital for small businesses. However, the loans are too small to enable households and business to make investment that have significant impact on earnings. The of obtaining digital loans also predisposes providers to risky borrowers. Other borrowers' borrower

with an intention of not borrowing, especially with week loan enforcement mechanism in Kenya. More importantly, the DCP relay on transactional and communication data as well as adverse rating from credit information system as a deterrent against potential defaulters. Yet, there is tendency for borrowers to change their behaviour once they obtain the loan, especially borrowers of small amounts.

The behavioural change after obtaining the loan may not be captured or predicted accurately by the scoring algorithms. However, the DCPs are effective in vetting borrowers than commercial banks and microfinance banks. As result, the DCP have lower NPLs ratio 16.02 percent in December 2024 and 15.9 percent in March 2025, compared to commercial bank NPLs ratio of 17.1 in December 2024 and 17.2 in March 2025. The NPLs ratio of borrowers loan amount below KSh 1000 and between KSh 1000 to KSh 5000, was 83.1 and 69.4 percent, respectively, while the borrowers of KSh 50,001 - 100,000 had the lowest NPLs ratio of 16.4 percent, which higher that banking sector NPLs ratio during robust growth and prudent credit risks management. The elevated credit in the DCPs require them to enhance credit risks management, including refining tools for identifying borrowers and their needs, which enabled them reduce loan default.

The Central Bank of Kenya Act has been amended over time to regulate commercial Banks, payment services provider, digital credit providers, remittance services providers, banking fraud as well as provide critical financial market infrastructure for trading in Government securities. These amendments enable the CBK to discharge its mandate. One of CBK's mandate is to foster the liquidity, solvency and proper functioning of a stable market-based financial system. A liquid and sound financial system support economic growth through financial intermediation. In order to effectively formulate and implement financial stability policy, the CBK established a Financial Stability Committee. The objectives and composition of the CBK financial Stability Committee is outlined in the **BOX II** below.

BOX II: FINANCIAL STABILITY COMMITTEE

Kenya's financial system has grown significantly by assets size, complexity (players, products and services) and interconnectedness within the country and across borders. In addition, the financial system has become more integrated in the economy, accounting for about 8 percent of GDP and contributes directly and indirectly to about 2 percent to GDP growth. The system is also very important in jobs creation in the country, for instance banking sector alone had about 38,000 direct jobs as of December 2023.

The significance of the financial system calls for more rigorous monitoring for timely identification of risks and taking appropriate mitigation measures. The 14th Meeting of the Joint Board of Directors of Financial Sector Regulators Forum, the Bank's 2024-2027 Strategic Plan, the 26th MAC Meeting and the IMF Financial Sector Stability Review reports, have all recommended the establishment of a Financial Stability Committee (FSC) for effective coordination and collaboration on matters financial stability. Subsequently, In line with the mandate to promote and maintain financial stability, the CBK established the Financial Stability Committee in February 2025. The FSC is chaired by the Governor, with Deputy Governors serving as Vice Chairpersons, while the Directors of the Research, Bank Supervision, Financial Markets, and Banking & Payments Services Departments, and the Heads of Legal, Communications, and Cyber Fusion Divisions as members. A technical team, comprising of staff nominated by the Directors, supports the committee's work. The Financial Sector Analysis Division within the Research Department serves as the FSC Secretariat, responsible for coordinating committee operations, maintaining records, and producing reports. The Governor retains discretion to appoint, invite, or remove members of the Committee. The FSC is responsible for formulation and implementation of financial stability policies that fall under the realm of the CBK. Other functions of the FSC are:

- Coordinate the formulation, implementation and periodic review of financial stability policies within the realm of the Central Bank of Kenya's mandate to achieve and maintain system-wide inclusive and stable financial system.
- Provide a platform for regular and periodic review of key risks, developments and policies that have implications on the financial stability by respective departments.
- Enhance information sharing and collaboration across various departments within the Central Bank on financial system stability matters.

- Direct and support the development and implementation of CBK's macroprudential policy and crisis management frameworks for the financial sector.
- Provide oversight and direction on emerging areas with implications on financial sector stability, including climate change, financial technologies and global developments.
- Enhance coordination of financial, monetary, fiscal and other policies with implication on financial stability, including communication both in regular and crisis periods.
- Undertake any other tasks that may be assigned to the Committee.

The FSC meets quarterly on the third week or as convened by the Chairperson. A quorum consists of the Governor or a Deputy Governor and at least four Directors or their alternates.

The inaugural meeting of the FSC was held on March 18, 2025, while the second meeting was convened in June 18, 2025. The meetings have enhanced coordination and communication of financial stability and crisis management issues across the Bank. The committee has also provided a platform for information sharing among departments, which has improved the effectiveness of CBK in conducting supervision, licensing and enforcing regulation. This has contributed to the effectiveness of CBK fostering and maintaining financial stability.

The establishment and operationalisation of FSC marks a significant milestone in CBK's institutional evolution toward a modern, proactive financial sector supervisor. Its establishment enhances macroprudential surveillance, promotes policy coherence, and positions Kenya in line with global best practice. The FSC's role is especially critical in the backdrop of financial innovation, climate risks, cyber threats, and geopolitical shocks posing increasing systemic risks. Therefore, the FSC will continue fostering financial stability by refining macroprudential tools, deepening interdepartmental coordination, and enhancing the resilience of the financial institutions to effectively mitigate emerging risks, such as climate change, cyber threats, and fintech disruptions. The FSC endeavours to make evidence-based decisions and aligned with international best practices, ensuring the Central Bank remains at the forefront of financial system oversight.

2.1.4 Banking Sector Safety Net and Resolution

Kenya Deposit Insurance Corporation (KDIC), is a Resolution Authority whose mandate is to provide the Deposit Insurance Scheme for banks, provide incentives for sound risk management and promptly resolve troubled banks. The Corporation's public policy objective alongside other safety net players is to promote public confidence and contribute to the stability of the country's financial system. In pursuit of this mandate, the Corporation manages a Deposit Insurance Fund (DIF) 'The Fund', which is designed to protect depositors by assuring them that they will have immediate access to their insured deposits in the unfortunate event of their bank failure, thereby reducing their incentive to make a "run" on the bank. In the period under review, this Fund increased by 18 per cent from Ksh 209 billion in December 2023 to KES 248 billion as of December 2024. The current protected amount or coverage is KES 500, 000 per depositor.

The deposit liabilities held by the banking sector declined by 1.5percent to close at KES 5.7 trillion as of December 2024. Ksh. 822 billion of these deposits or 14 percent are fully protected by the Fund in the event of bank failure.

The effective cover of the deposit, which is expressed as the total Fund held against the protected deposit during the year increased from 24percent to 30.25percent. The increase is attributed to growth of the Fund as well as the increased customers transactional activities which reduces bank balances. In terms of value of deposits protected, there has been a steady decline from 15% to 14%. This value is below the International Association of Deposit Insurance (IADI) recommended minimum value of 20%. However, at the current coverage limit of KES 500,000, 99% of the 115.3 million bank accounts in December 2024, were fully protected as they fell under the coverage limit (**Table 6**).

Table 6: Select Key Fund Indicators for KDIC

Year Ending December	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Annual Change in percent (2023 - 2024)
Total Deposits (KSh Billion)	2,384.7	2,674.0	2,783.7	3,075.8	3,385.2	3,605.5	4,151.8	4,472.0	4,777.5	5,839.8	5,749.2	-1.6
Total Insured (KSh Billion)	224.9	244.7	255.5	272.1	269.7	285.1	694.0	715.0	750.6	857.8	822.7	-4.1
Protection Level (Row2/Row1) (%)	9.43	9.15	9.18	8.85	7.97	7.91	16.72	16.0	15.7	14.7	14.3	-2.6
Fund Balance (KSh Million)	52.2	61.7	73.3	86.1	100.2	115.1	126.0	154.0	179.8	209.2	248.9	19.0
Effective Cover (Row4/Row2) (%)	23.2	25.2	28.66	31.64	37.13	40.35	18.15	21.7	24.0	24.4	30.3	24.0
Total no. of accounts (KSh 000)	30.7	37.4	43.3	49.9	57.3	64.7	72.7	68.9	67.0	107.0	116.1	8.5
Accounts fully covered (KSh Million)	29.6	36.1	41.8	48.4	55.9	63.1	72.0	68.2	66.4	106.2	115.3	8.6
Protected accounts (Row7/Row6) (%)	96.25	96.65	96.72	96.86	97.44	97.56	99.13	99.1	99.1	99.3	99.4	0.0
Exposure Level (100% - Row 5) (%)	76.8	74.8	71.34	68.36	62.87	59.65	81.85	78.3	76.0	85.3	69.7	-18.2
Target Fund (%)	2.3	2.3	2.6	2.8	3.0	3.2	3.0	3.4	3.8	3.58	4.3	20.9

Source: KDIC

The risk exposure level to the Fund decreased from 85 per cent in December 2023, to 69 per cent in December 2024 with the implementation of the risk-based premium model. The model rewards member banks for proactively investing in and implementing sound risk management frameworks. KDIC continues to implement appropriate resolution frameworks to ensure that in case of a failure of an institution, the process of resolution is effective and timely in collaboration with other safety net players.

The KDIC published guidelines on trust account in 2025 to enhance protection of deposit for beneficiaries by clarifying how trust account balances are aggregated, segregated, and insured. The guidelines stipulate that all deposits held by the same trustee for a single beneficiary are aggregated into one balance for insurance purposes, to reduce fragmentation of accounts to maximize coverage. The guidelines also require

separation of trust deposits from a trustee's personal funds, which not only provides a fair and direct full cover of deposit for beneficiaries but also enhances transparency and prevents misuse. These reforms are expected to boost depositor confidence and improve financial system resilience. Institutions will therefore need to strengthen systems for account labelling, reporting, and record-keeping to comply with quarterly disclosure requirements, while trustees must maintain accurate beneficiary records to ensure claims are honoured swiftly in the event of bank failure. For KDIC, the guidelines provide a firmer basis for oversight and reimbursement processes, reducing ambiguity and aligning Kenya's framework more closely with international deposit insurance best practices. Overall, the reforms set the stage for more reliable protection of trust account balances and accountability among both institutions and trustees.

Box III: May 2025 Banking Sector Stress Test

The May 2025 stress test assessed the resilience of Kenya's banking sector to credit risk, cyber security risks, and impact of new capital requirements by December 2025. Private sector lending remained low, albeit modest recovery. The non-performing loans (NPLs) remained high and rising, relative to growth in lending, thus leading to NPLs ratio increasing from 15.6 percent in December 2023 to 17.1 percent in December 2024 and 17.6 percent in April 2025.

Factors identified as explaining elevated credit risk include unfavourable business environment, moderation in growth, and slow pace of new lending. The sectors of the economy that mainly accounted for decline in new lending and increase in NPLs in 2024 through March 2025 were Real Estate, Transport & Communication, Trade, and Personal & Households. The pace of recovery in new lending may be moderated further in 2025 as some banks focus on capital accumulation and preservation to meet the new regulatory capital requirement of KSh 3.0 billion by December 2025. This increase that ultimately rises to KSh 10.0 billion by 2029, from KSh 1.0 billion set in 2012 may be a shock to some banks. A combination of low lending amid declining interest rates on government securities and loans & advances, could reduce bank earnings, thus limiting the ability of banks to build required capital buffers by December 2025.

The banking sector is adopting technology to deliver financial services to meet the ever-evolving customer needs, bringing efficiency gains as measured by deposits and profits per staff. However, this has come with vulnerabilities to cyber-attacks, especially for those banks with resource constraints to invest in robust cyber security defenses. Materialization of cyber-attacks on such banks lead to loss of money and/or denial of services, potentially impacting earnings and credibility.

Against this background, the May 2025 stress test was conducted considering three trigger events; (i) slowdown in economic activities amid challenging business environment that lead to increased NPLs and reduced lending; (ii) increased operational risks due to successful cyber-attacks; and (iii) increase in core capital requirement that come as a shock to some banks. The stress test audited bank level data for December 2024.

Overall, the results of the stress test assessed for the three trigger events indicate that in the baseline, the banking sector is resilient to shock increase in NPLs and reduced lending, and successful cyber-attack. In addition, the baseline stress test that applied shocks of the May 2024 stress test scenario to the May 2025 stress test data, indicate that the banking sector is more resilient as indicated by the decline in the number of banks that failed the stress test and amount of capital required to meet the minimum core Capital Adequacy Ratio (CAR) of 10.5 percent by December 2025.

However, a credit risk stress test under a severe scenario of subdued lending, 27.4 percent increase in overall NPLs and largest increase in sectoral NPLs show that six (6) banks may not meet the minimum core CAR of 10.5 percent by December 2025. The same banks recorded capital shortfall below the minimum core CAR when it was adjusted for full provisioning requirements in line with CBK Prudential Guidelines. These banks require KSh. 5.1 billion in additional capital to fully comply with regulatory capital requirement.

The scenarios used in the stress test are plausible and realistic given that actual NPLs increased by 7.4 percent in the year to December 2024 and a 5-year (2020-2024) average annual NPLs growth rate was 19.2 percent. The impact of earnings to shore up capital was incorporated in

the stress test model by assuming a 15 percent retention in profits after tax. This was derived from historical data since 2017 (except for COVID-19 period) where 15 percent of retained profit after tax have been moved to reserves to form part of core capital.

The stress test was also conducted to assess the impact of transitioning to new core capital of KSh 3.0 billion by December 2025 from the KSh 1.0 billion that has been in place since 2012. By June 2025, eleven (11) banks had core capital of less than KSh 3.0. billion, that takes effect December 2025 under the Business (Amendment) Laws 2024. Therefore, before applying any shock scenario, these banks require additional KSh 14.7 billion to fully comply with the new capital requirement. Applying a severe stress scenario where NPLs increase by 27.4 percent, twelve (12) banks may not meet the new capital requirement. These banks would need KSh 19.8 billion in additional capital to meet the new capital requirement by December 2025. The mitigation, however, is that these banks have submitted their Internal Capital Adequacy Assessment Process (ICAAP) plans containing measures to shore up capital.

The cyber risk stress test was calibrated by assuming that 5 percent probability of cyber-attacks are successful, leading to the loss of money and loss of revenues due to denial of services. This in turn negatively affect earnings and ultimately, capital. The results indicate that the banking sector would incur losses amounting to KSh. 2.9 billion under severe scenario if this risk materializes. As a result, 5 banks fail the stress test under severe scenario and require a capital injection of KSh. 2.4 billion to meet minimum CAR. These banks also fail the stress test of credit risk and are not fully meeting the provisioning requirements.

Overall, credit risk remains the most significant and therefore requires continued monitoring to maintain stability. This would involve analyzing exposure to the most vulnerable sectors as well as business models and growth prospects of large borrowers. In addition, a continuous monitoring for full implementation of the Internal Capital Adequacy Assessment Process (ICAAP) plans submitted to the Bank is paramount to ensure that those banks affected by the new core capital requirements, fully comply by December 2025. However, the Bank may stand ready with options of: (i) downgrading such banks to Microfinance Banks and reinstate them upon meeting the new core capital requirements; (ii) consider extending the Ksh 3.0. billion target period for such banks or (iii) consider amending the law to allow tiered capital as is the practice in other mature jurisdictions to accommodate the niche market for such banks. Lastly, the rising cyber security threats pose elevated operational risks and therefore the necessary cyber security frameworks must be implemented to mitigate the cyber risks.

Background

The May 2025 stress test assessed the impact of increase in NPLs, new core Capital requirement of KSh 3.0 billion and materialization of cyber-attacks on core capital of Banks by December 2025. This annual stress test assessed the banking sector's resilience to hypothetical but plausible and realistic shock scenarios. The shocks used in the scenarios are calibrated from economic conditions, significant decline in new lending amid rising NPLs as banks tighten lending standards, and recent increase in the core capital from KSh. 1 billion to KSh. 3 billion by December 2025. The impact is estimated by the amount of capital shortfall, additional capital needed to meet the minimum regulatory requirement and the number of banks not meeting the minimum capital requirement if the scenarios materialize.

STRESS TEST

Assumptions underpinning stress test scenarios

Economy grows by 4.2 percent in 2025, below the baseline forecast of 5.4 percent on account of:

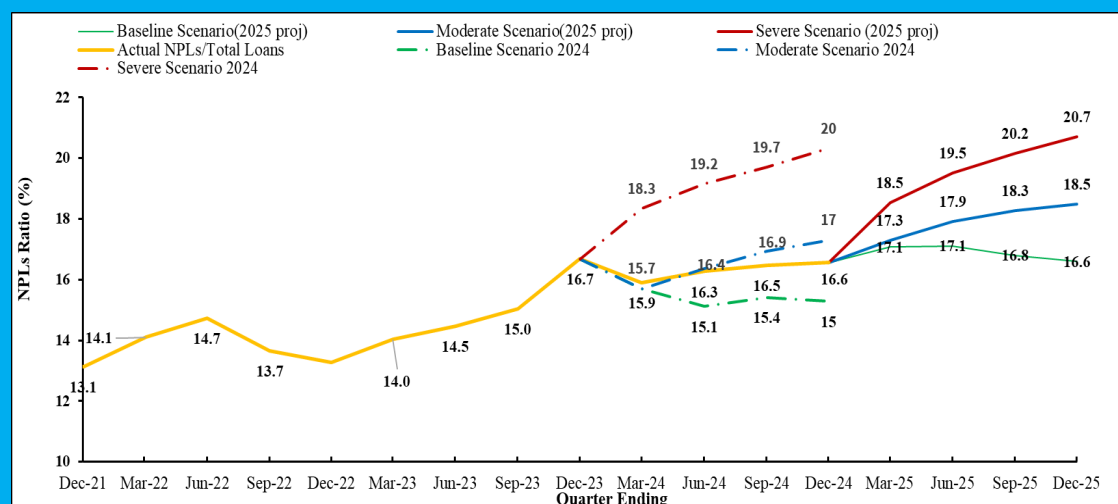
Legacy challenges, unpredictable weather conditions, trade and geopolitical tensions. Narrow fiscal space that limits Government's capacity to support growth and uncertainty in fiscal policy, especially on taxation and the path for fiscal consolidation Subdued lending to the private sector. Banks retain 15 percent of the profit as capital buffers against shocks

Economic sectors most vulnerable to these downside risks are manufacturing, agriculture, trade, real estate and personal and household. These sectors accounted for 14.5 percent, 3.7 percent, 18.3 percent and 12.5 percent and 26.6 percent of gross loans, in December 2024. The sectors also accounted for 18.2 percent, 4.5 percent, 22.0 percent, 17.6 percent and 15.5 percent of total NPLs, respectively. Therefore, further economic slowdown coupled with new capital requirements could lead to further reduction in new lending, thus elevating credit risk.

If the above assumptions hold, gross loans are projected at KSh. 4,195.0 billion under severe scenario against the baseline of KSh. 4,681.4 billion in December 2025. The actual stock of loans was KSh 4,070.2 billion in December 2024 and KSh 4,147.34 billion in June 2025 Key sectors projected to drive growth in gross loans under alternative scenarios are manufacturing, transport & communication, and trade. These sectors are also the most exposed to fiscal consolidation, taxation and decline in household and corporate demand due to decrease in disposable income. Building & construction, and real estate sectors are projected to record the slowest growth in new lending in 2025 due to shift of business and office operations to online, decline in disposable income

The Gross NPLs are projected at KSh. 888.7 billion under severe scenario against a baseline projection of KSh. 765.1 billion in December 2025. Consequently, the declining gross loans against rising NPLs is projected to drive the NPLs ratio to 21.2 percent under Severe scenario against the baseline projection of 16.3 percent by December 2025. The actual NPLs ratio was 17.1 percent in December 2024 and 17.6 percent in April 2025. The sectors projected to drive NPLs under severe scenario are Trade, Real Estate, Transport & Communications and Manufacturing **(Figure i).**

Figure i: Projected Non-Performing Loans Ratio



Source: Staff Computations

Evaluation of forecast errors between the actual and projected gross loans, NPLs and NPLs ratio indicates relatively better degree of accuracy. The forecasted NPLs ratio was above the actual by an average of 0.25 percentage points in 2024, slightly higher than 0.22 percentage points in 2023. Additionally, the actual NPLs were much lower than the forecast, by an average of KSh 37.3 billion in 2024 compared to an average increase of KSh. 18.8 billion in 2023 (**Figure ii**).

Figure ii: Forecast Evaluations from previous Projections

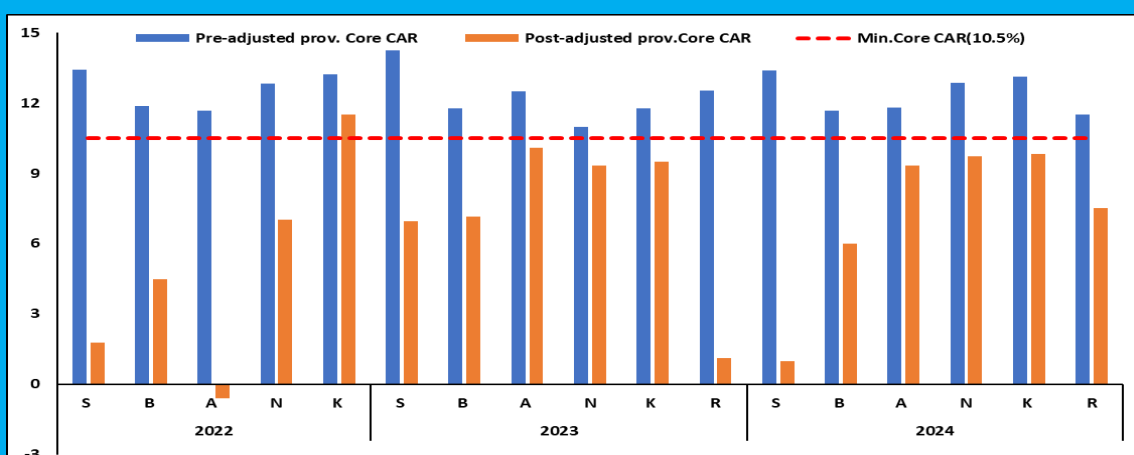
VARIABLE	Jun-22			Sep-22			Dec-22			Mar-23			Dec-23			Mar-24		
	Actual Growth	Forecast Value	Deviation from Forecast	Actual Growth	Forecast Value	Deviation from Forecast	Actual Growth	Forecast Value	Deviation from Forecast	Actual Growth	Forecast Value	Deviation from Forecast	Actual Growth	Forecast Value	Deviation from Forecast	Actual Growth	Forecast Value	Deviation from Forecast
Gross loans (KSh Bn)	3,492.80	3,578.85	-86.05	3,594.70	3,552.66	42.04	3,630.25	3,587.23	43.02	3,852.28	3,790.06	62.22	4,183.45	4,119.31	64.14	4,083.55	4,172.06	(88.51)
NPLs (KSh Mn)	514.41	494.41	20.00	491.14	486.05	5.09	503.24	481.58	21.66	540.78	538.93	1.85	651.81	616.12	35.69	641.25	652.86	(11.61)
NPLs/Gross Loans (%)	14.73	13.81	0.91	13.66	13.68	-0.02	13.86	13.42	0.44	14.04	14.22	-0.18	15.58	14.96	0.62	15.70	15.65	0.05

Preliminary Analysis

The May 2025 stress test was conducted on banks that fully met the regulatory capital requirements before applying any shock (Figure 19). Consequently, six (6) banks were not included in the stress test as their core capital to total risk weighted assets ratio (core CAR) fell below the 10.5 percent regulatory threshold before any shock applied. These banks require KSh. 5.4 billion in additional capital to meet the regulatory capital requirement. The one however is under acquisition thus reducing the number of banks to five (5) with revised additional capital required at KSh. 3.9 billion.

The remaining thirty-three (33) banks were adjusted for full provisioning for capital adequacy in line with Prudential Guidelines¹. The post-provisioning Core CAR of four (4) banks declined below regulatory minimum of 10.5 percent and require additional KSh. 2.3 billion in capital to meet the minimum core CAR, an improvement from the 2023 stress test. Thus, banks have used their profits in 2024 to build additional capital to comply with new regulatory requirement. However, core CAR for Bank of Africa and Sidian bank remains below the regulatory requirement after adjustment for full provisioning since 2022 indicating vulnerability to shocks (Figure iii).

Figure iii: Core CAR post- full provisioning adjustment



¹ This entails setting aside capital to compensate for the loan losses arising from default

Credit Risk stress test results

Baseline/Uniform stress test: Shocks Calibrated from Historical NPLs reflecting economic, policy and lending conditions in May 2024 stress test

The May 2025 Baseline (Uniform) stress test uses the shocks used in the May 2024 stress test on the December 2024 data to assess the resilience of the banking sector if such shocks materialize in 2025. This helps us to assess whether banks built additional capital buffers and implemented required measures to deal with shocks that existed in May 2024 and are likely to persist in 2025. The 2024 Baseline stress test assumed that NPLs increased by 10.2 percent, 17.2 percent, and 28.9 percent under the baseline, moderate and severe scenarios. As a result, NPLs would grow to KSh 695.7 billion, KSh 711.4 billion and KSh738.0 billion under the baseline, moderate and severe scenarios, respectively, by December 2025 (Figure v).

Figure iv: Baseline Stress Test Results Based on December 2024 Data

Transmission Channel	Impact on Minimum Core CAR due to Increase in NPLs	May 2024 Stress Test Based on December 2023 Data			May 2025 Stress Test Based on December 2024 Data		
		Baseline Scenario	Moderate Scenario	Severe Scenario	Baseline Scenario	Moderate Scenario	Severe Scenario
Size of the Shock Applied Under Each Scenario		10.21	17.15	28.91	10.21	17.15	28.91
1. A Shock Increase in Overall NPLs	Pre-shock Core Capital Ratio (%)	15.75	15.75	15.75	17.63	17.63	17.63
	Post-shock Core Capital Ratio (%)	14.23	14.02	13.67	16.27	16.08	15.75
	Number of Banks below minimum Core CAR	6	6	7	5	6	6
	Capital required (KSh Mn) by banks to meet the minimum Core CAR of 10.5%	17,953.18	21,466.67	27,600.24	3,195.13	3,915.51	5,225.74
2. A Shock Increase in Sectoral NPLs	Pre-shock Core Capital Ratio (%)	15.75	15.75	15.75	17.63	17.63	17.63
	Post-shock Core Capital Ratio (%)	14.29	14.10	13.76	16.34	16.18	15.88
	Number of Banks falling minimum Core CAR	6	6	8	5	6	6
	Capital required (KSh Mn) by banks to meet the minimum Core CAR of 10.5%	17,571.93	20,372.10	26,185.76	3,271.23	4,094.36	6,057.38

Overall, banks hold adequate capital to withstand a severe shock and continue lending by December 2025. Under the severe scenario, a 28.91 percent shock increase in overall NPLs would reduce core CAR from 17.6 percent in pre-shock to 15.8 percent, which is still above the minimum core CAR of 10.5 percent. A total of six (6) banks may not meet the minimum regulatory capital threshold if this shock materializes a reduction from 8 banks in May 2024. Consequently, the amount of capital injections required to comply with regulatory requirements reduces to KSh. 5.2 billion in December 2025 if the severe scenario materializes. Of the total, two (2) banks are tier II, and four (4) banks are in tier III. Compared to the May 2024 stress test, the May 2025 stress test shows enhanced capital buffers as indicated by post-shock core CARs, the number of banks affected, and amount of additional capital needed to meet minimum capital requirement. The results under the sectoral shocks scenario shows less concentration risks given the high Core CARs, lower number of banks affected and less amount in additional capital needed in post-shock period.

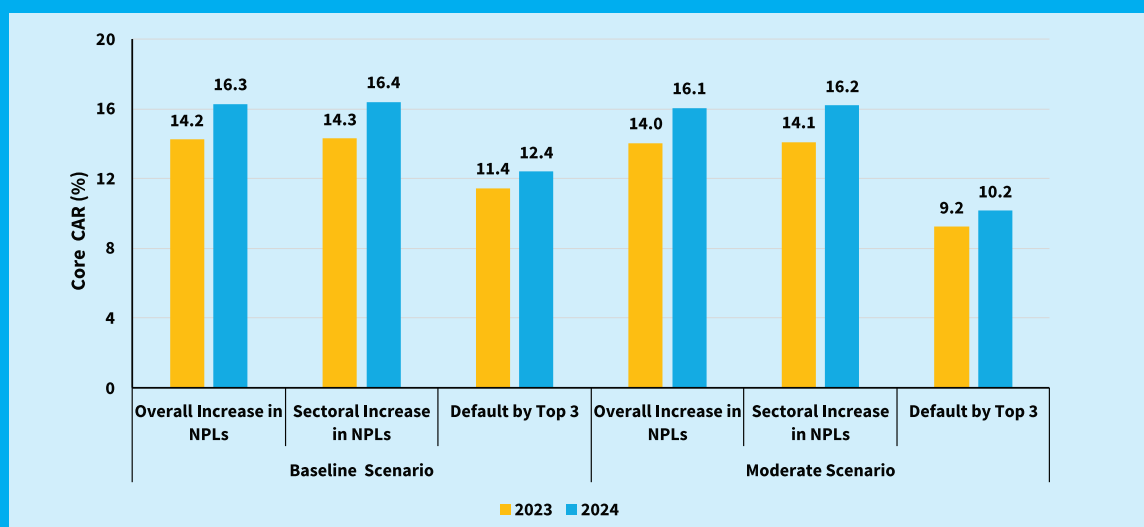
Event-based Stress Test 1: Shocks Based on Economic, Financial and Policy Environment

This stress test assumes that unfavorable business conditions, reduced lending, monetary and fiscal policies tightening, negatively impact firms and households' incomes. This reduces their ability to service existing loans and/or take up new loans, contributing to increase in NPLs ratio. The shocks can be transmitted through increase in Overall NPLs; increase in sectoral NPLs; and default by top borrowers per bank (1, 2 and 3 top borrowers per bank default under the baseline, moderate and severe scenarios, respectively).

Under severe scenario, a 27.4 percent shock increase in overall NPLs would result in 6 banks requiring a total of KSh. 5.1 billion in capital injection to fully comply with regulatory capital minimum of 10.5 percent by December 2025. The core CAR would decline to 15.79 percent in a post-shock severe scenario from the pre-shock core CAR of 17.63 percent. The size of shocks calibrated under this stress test are less mild compared to those used in the May 2024 stress test, reflecting improved macroeconomic conditions, easing monetary conditions and recovery in bank earnings. The most significant shock is a default by the top three borrowers per bank under severe scenario by December 2025.

If the shock materializes, the sector will require KSh. 220.74 billion to meet the regulatory capital requirement by December 2025, signifying higher concentration risk/single borrower exposure in 2024. This amount and number of banks affected are below the May 2024 stress test, implying improved stability of the banking sector (Figure vi).

Figure v: Shock Increase in NPLs due to Unfavourable Macro financial Conditions



Overall, the sector was less vulnerable to risks transmitted through the 3 channels in the May 2025 stress test as compared to the May 2024 stress test. Thus, except for those failing the stress test, the banking sector is better prepared to absorb shocks emanating from changes in macroeconomic conditions, signifying stability and resilience in 2025. The improved resilience of the banking sector is due to an increase in core capital and provisioning, which enabled banks to absorb credit losses and continue lending.

The credit risk transmitted through default by top borrowers per bank 2025 remains the most significant. However, the number of banks failing this stress under severe scenario has declined from 20 banks in the May 2024 stress test to 19 in May 2025 stress test. The amount of capital required for these banks to meet the minimum core CAR of 10.5 percent decreased from KSh. 239.0

billion in the May 2024 stress to KSh. 220.7 billion in the May 2025 stress test. Concentration risk is higher for Tier I banks, with six (6) of the nine (9) banks in this group being affected. Four (4) banks in tier II group and nine (9) banks in tier III would not meet the minimum capital requirement by December 2025 if top 3 borrowers per bank default on their loans. The six (6) tier I banks account for 86.3 percent of total capital shortfall. The top borrowers are concentrated in transport, energy real estate and manufacturing sectors.

Event-based Stress Test II: New Core Capital of KSh. 3 billion by December 2025

This stress test was undertaken to assess the ability of banks to raise core capital to KSh. 3 billion through retained earnings by December 2025. The stress test was underpinned by the following assumptions:

Banks may not raise additional capital through rights issue or a strategic investor

Existing shareholders are not able to inject additional capital

Only realised Internal Capital Adequacy Assessment Plans are considered

Profits grow at an average of the last four years, excluding COVID-19 period

Banks build their core capital from retained earnings after paying 30 percent corporate tax

The capitalization of profits first meets the specific and general provisions to mitigate credit risks under baseline, moderate and severe scenarios. Therefore, the trajectory of NPLs under the baseline moderate and severe scenarios is based on the developments of economic and financial condition in the domestic and global economy and is as follows:

Baseline Scenario: assumes an increase in NPLs of 9.7 percent

Moderate Scenario: NPLs will increase by 17.9 percent.

Severe Scenario: Assumes in NPLs by 27.4 percent.

The results indicate that 12 banks in tier III may need to explore other sources beyond profitability/retained earnings channels in line with their ICAAP in order to raise core capital to KSh. 3 billion by December 2025 under severe scenario based on actual core capital and profitability for June 2025. If the scenario materializes, they will require a total KSh. 19.8 billion in six months to December 2025, in additional capital to fully attain the new capital requirement (Figure vii). This is lower than KSh. 22.5 billion estimated in January 2025.

Figure vii: Capital injection needed to Comply with Ksh. 3 billion

	Baseline Scenario (9.7 Percent)	Moderate Scenario (17.9 Percent)	Severe Scenario (27.4 Percent)
Bank 1	-	-	93,107
Bank 2	375,228	423,725	480,213
Bank 3	488,450	655,893	850,925
Bank 4	4,503,573	4,503,573	4,503,573
Bank 5	895,940	1,404,789	1,997,480
Bank 6	113,689	160,535	215,100
Bank 7	833,302	833,302	833,302
Bank 8	2,125,485	2,142,457	2,162,225
Bank 9	1,484,530	1,484,530	1,484,530
Bank 10	894,585	894,585	894,585
Bank 11	3,621,480	3,621,480	3,621,480
Bank 12	1,420,777	1,973,926	2,618,216
Total	16,757,037	18,098,795	19,754,736

Cyber Risk Stress Test

This stress test was undertaken to assess the resilience of the banking sector to cyber losses. It is estimated that the cost of Malware, Web application, Botnet/DDOS and system vulnerabilities/misconfiguration attack cost the banking sector KSh. 20 billion annually. However, investment in cyber defences reduce the probability of successful attacks and the cost of restoring services. Using historical data, it is estimated that the probability of successful cyber-attack is 5 percent with 2 standard deviations. Successful attacks lead to increase in operational cost to restore services and a decline in revenue because of distributed denial of services. The losses amount KSh. 32.8 million, KSh. 2.1 billion and KSh. 2.9 billion is lost under the baseline, moderate and severe scenarios, respectively. The losses will lead to capital decline leading to some banks to fail the test in terms of their capital dropping below the required minimum.

SUMMARY OF STRESS TEST RESULTS

Credit risk remains elevated albeit easing on account of improving macro-financial conditions. Declining interest rates on both government securities and on loans and advances amid slower pace of new lending and new capital requirement, may strain incomes of some banks, especially those in Tier III, thereby reducing their capacity to raise KSh. 3 billion in core capital by December 2025. This exposes them to vulnerabilities.

Concentration risk remains high but easing as reflected by the number of banks affected and amount of capital needed if top 3 borrowers per bank default under severe scenario.

Operational risk has increased as reflected by the frequency and scale of cyber-attacks, which may impact bank operations and reduce earnings.

RECOMMENDATIONS

- Banks to ensure full implementation of the Internal Capital Adequacy Assessment Process (ICAAP) plans prioritizing compliance with the new capital requirement.
- Banks to adequately provide for their assets to ensure that provisions reflect risk appetite
- Closer monitoring of top borrowers per bank, including a review of banks' business models and those of their top borrowers to mitigate concentration and credit risks
- Closer monitoring of banks to enhance their cyber security frameworks to mitigate cyber risks

2.1.5. Risks Assessment and Outlook for the Banking Sector

The banking sector remained stable and resilient in 2024 and first half of 2025, on the backdrop of tight financial conditions, challenging operating environment, moderation in economic growth, and fiscal consolidation. The sector has adequate capital, and liquidity buffers and remains profitable. However, the sector faces downside risks in 2025 and 2026 arising from domestic and global macroeconomic and policy developments as well as institutional challenges that require closer monitoring for timely and effective policy interventions. Among the downside risks discussed in this report are credit, concentration risk, contagion risk and cyber risk attributable to continuous adoption of technology. These have been assessed through macro stress testing using audited bank balance sheet data as of December 2024. The results are summarised in the abridged version of the report in Box I. Other risk includes climate change related and liquidity risks.

Credit risk remains elevated as reflected by high non-performing loans and slow growth in new lending. This is projected to persist in the remainder of 2025 and better part of 2026 on account tight financial conditions and tight lending standards. The sector is also faced with challenging business environment characterised by delays in loan repayments by households and firms. This has been partially attributed to, high taxation and other levies, and delays by government to pay suppliers of goods and services as fiscal consolidation continues to be implemented.

Liquidity risk remains low but may change with envisaged reforms. While liquidity ratios have remained well above the minimum regulatory requirement of 20 percent. However, the proposed improvement in the measurement of liquidity through incorporation of Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) into the CBK's current liquidity framework as envisaged under the Internal Liquidity Adequacy Assessment Process (ILAAP), may drive some banks to experience elevated liquidity risks. In addition, the proposed implementation of the Treasury Single Account, could impact negatively for some banks that hold large amounts of government-related deposits if this is done abruptly.

Climate change shocks are posing risks to Kenya's financial sector stability. The main risks arising from Climate change shocks to Kenya are physical risks as reflected by damage caused by floods in 2023 and frequent drought events impacting growth and inflation. Sectors such as agriculture, transport, tourism and energy, which accounted for 18.8 percent of gross loans and 17.4 percent gross NPLs in December 2023, have in the past borne the brunt of extreme weather events, highlighting the overall direct impact on the financial sector. While the transition and liability risks are less prominent for now, banks with exposure to high carbon emission sectors are likely to face transition risk with compliance to new standards for climate change. In the outlook, the, the government and financial sector players have initiated measures to

address this risk while at the same time tap into its emerging opportunities.

Operational and governance risks expected to rise as banks become more interconnected with sectoral and cross-border operations coupled with rapid technological innovations.

Expansion of Kenyan banks in the East African region not only comes with country risk, but it also introduces governance issues if not well managed. This combined with expansion into other sectors such as insurance, capital markets and even non-financial related sectors, comes with institutional complexities that can be a source of risks. Risks transmission through this channel has not materialised in the past but requires closer monitoring of interconnectedness.

Perhaps the most significant and emerging operational risk facing the financial sector is associated with the rapid adoption of financial technologies to power the delivery of financial products and services. The incidences of frauds, data privacy concerns, cyber-attacks, and cybersecurity threats increased in 2024. The authorities are alive to these risks and are therefore taking more prudent and stringent remedial controls and risk management measures to address them. Among the major policy developments to address this risk to financial stability was the publications of the Digital Credit Providers regulations following amendments to the Central Bank of Kenya (Amendment) Act No 10 of 2021, and that became effective on December 23, 2021, thus mandating the CBK to bring the

previously unregulated digital lenders under its regulatory arm pit. CBK have received over 400 DCP applications, 32 have been licensed while others are in various stages of the licensing process.

2.1.6. Policy Developments in the banking sector to enhance financial stability

Increase in Bank's Minimum Capital Requirements:

Following the enactment of the Business Laws (Amendment) Act, 2024, the minimum capital requirements for banks was raised to Ksh.10 billion by 31st December 2029. The Central Bank of Kenya (CBK) asked all 24 banks with minimum core capital below Ksh.10 billion to submit their board approved capital build up plans by April 1, 2025. So far, 22 of the 24 banks have submitted the plans with two banks that are subsidiaries of foreign banks expected to submit their plans by 30th April 2025. The plans outline strategies to raise capital including injections, rights issues, strategic partners, mergers and organic growth. CBK is currently reviewing the plans in detail ahead of further engagements with the specific banks.

Greening of the Financial System: On April 3, 2025, the Central Bank of Kenya (CBK) issued the Kenya Green Finance Taxonomy (KGFT) and the Climate Risk Disclosure Framework (CRDF) for implementation in the banking sector. This initiative is part of CBK's ongoing second-generation reforms aimed at promoting sustainability and greening the banking sector. The KGFT aims to help institutions evaluate and classify their economic activities based on their

alignment with climate objectives and support for the transition to a low-carbon economy. Institutions are expected to use this taxonomy to assess how their business activities align with these goals. The Climate Risk Disclosure Framework will assist commercial banks in collecting and disclosing climate-related information in a consistent and comparable way. For investors, the framework provides essential data to evaluate the financial impact of climate change on investments and identify companies well-positioned for the low-carbon transition. There will be a transition period of 18 months before the full implementation of the taxonomy and disclosure framework. During this period, CBK will build the capacity of its staff and the banks.

License Fees: The Central Bank of Kenya (CBK) on March 7, 2025, issued a consultative paper on review of commercial banks licence fees in Kenya for feedback by March 31, 2025. The objective of the proposed review has been necessitated by the increasing level of oversight by CBK which requires significant resources to effectively discharge its supervisory mandate, including Consolidated and Cross border Supervision. In addition, the proposed review is aimed at establishing a licence fee framework aligned with international standards and modern banking dynamics. The comments received are being analysed.

Review of Banking Sector Penalties: The Banking Act was amended through the Business Laws (Amendment) Act, 2024, introducing a new penalty assessment approach. Penalties are now the higher of

Ksh.20 million or three times the financial benefit gained/loss avoided. The amendment ensures penalties are, Effective, Proportionate, Dissuasive, aligned with global standards, and Entrench compliance culture in banks.

Lifting of Moratorium on Licensing of New Commercial Banks in Kenya: Effective July 1, 2025, the Central Bank of Kenya (CBK) lifted the moratorium on the licensing of new commercial banks. The moratorium, which has been in place since November 17, 2015, was introduced in response to governance, risk management, and operational weaknesses observed in the banking sector at the time. Its primary objective was to create space for strengthening the resilience and integrity of the sector. Since then, substantial progress has been made in enhancing the legal and regulatory framework governing Kenya's banking industry. This period has also seen several mergers and acquisitions, as well as the entry of both domestic and international strategic investors, contributing to sector consolidation and stability. Further reinforcing this trajectory is the recent enactment of the Business Laws (Amendment) Act, 2024, which raised the minimum core capital requirement for commercial banks to Ksh.10 billion. Upon the lifting of the moratorium, any new applicants seeking to enter the Kenyan banking sector will be required to demonstrate their ability to meet this enhanced capital threshold as a condition for licensing.

Liquidity Coverage Ratio, Net Stable Funding Ratio and Leverage Ratio Guidelines: CBK

issued draft Guidelines on the Liquidity Coverage Ratio (LCR), Net Stable Funding Ratio (NSFR), and Leverage Ratio (LR) for the banking sector on November 15, 2024, inviting public consultations and feedback by December 31, 2024. The guidelines are aimed at strengthening the banking sector liquidity and capital adequacy. The LCR guideline ensures banks maintain enough High-Quality Liquid Assets (HQLA) to withstand a 30-day liquidity stress scenario. The NSFR promotes stable, long-term funding by requiring banks to match long-term assets with stable funding sources. The LR ensures banks hold sufficient core capital relative to total exposures, limiting excessive leverage. The approved Guidelines, incorporating stakeholder feedback, were issued to the banking sector on April 17, 2025. These guidelines will take effect on October 1, 2025, after a six-month transition period.

Anti-Money Laundering/Combating the Financing of Terrorism/ Countering Proliferation Financing (AML/CFT/CPF):

In February 2024, Kenya was placed under the International Country Risk Guide (ICRG) process and publicly identified by the Financial Action Task Force (FATF) as a country with strategic deficiencies in its AML/CFT/CPF framework. In this regard, the key recommended actions to be addressed by CBK include:

- Improving risk-based supervision of AML/CFT through strengthening the human, technical and financial resource capacities of the AML/CFT supervisory authorities.
- implementing risk-based supervision of non-banking financial institutions.

- adopting a legal framework for the licensing and supervision of Virtual Asset Service Providers (VASPs).
- enhancing the understanding of preventive measures of financial institutions with focus on Customer Due Diligence (CDD), Enhanced Due Diligence (EDD), Beneficial Ownership (BO), Politically Exposed Persons (PEP) and Targeted Financial Sanctions (TFS).

2.2 Insurance Sector

The industry comprised of 59 insurance companies, 5 microinsurance companies, 5 reinsurance companies, 237 insurance brokers, 25 bancassurance intermediaries and about 15,000 insurance agents. The industry is segmented into long-term (life) and short-term (general) insurance with a notable dominance of the market by the short-term business in terms of premium at 52 percent. However, the long-term insurance business segment has been experiencing a higher growth rate over the years in terms of assets. The life insurance business segment's asset constitutes about 75 percent of total assets. The insurance industry has exhibited consistent growth with gross written premiums increasing by 8.3 percent to Ksh 395 billion in 2024 from Ksh 365 billion in 2023, while net profit increasing by 27 percent to Ksh 33 billion on the backdrop of high returns from investments.

Table 7: Key Performance Indicators for Insurers

Indicator	Years								Annual Change
	2017	2018	2019	2020	2021	2022	2023	2024*	
	KSh '000'	KSh '000'	KSh '000'	KSh '000'	KSh '000'	KSh '000'	KSh '000'	KSh '000'	
Gross Premium Income	209,001,289	216,261,729	229,499,718	234,775,753	273,710,831	310,273,121	364,852,109	395,301,449	9.4%
Net Premium Written	165,852,034	172,322,202	182,658,282	187,853,004	221,133,803	249,190,282	287,465,804	312,118,504	10.0%
Claims Incurred (Gen. Business)	56,151,961	56,928,003	58,961,581	58,311,459	69,835,740	77,095,539	87,860,423	95,738,185	11.2%
Commissions	12,495,181	11,487,628	10,957,562	11,157,093	13,521,938	15,341,053	17,201,794	17,028,900	-0.0%
Management Expenses	41,197,262	44,072,857	45,702,207	44,173,611	46,513,554	50,280,745	58,137,365	58,578,450	5.3%
Investment Income**	51,675,571	44,514,367	66,982,398	50,608,392	70,308,222	66,827,002	76,493,164	131,387,468	71.8%
Profit/Loss After Taxation**	13,642,972	7,269,268	15,119,928	6,388,955	8,645,622	14,715,312	26,179,548	33,146,578	73.0%
Investments**	483,799,656	524,237,249	594,568,115	656,460,833	733,461,323	833,722,972	933,663,301	1,098,847,017	17.1%
Assets**	590,953,337	635,035,110	709,045,429	765,932,477	850,506,382	956,871,079	1,057,910,702	1,237,412,888	16.2%
Shareholders' Funds**	147,255,007	149,134,602	161,635,278	166,069,303	167,914,107	184,166,513	209,777,709	239,808,341	18.1%
* Provisional unaudited data									
**Amounts include reinsurance business									

Source: IRA

The sector's total assets grew by 17 percent to KSh 1.2 trillion as of December 2024, largely driven by strong growth in income generating investments. The long-term insurance business constituted the largest portion of total assets and investments at 77 percent in equal proportions. This is in support of the long-tailed nature of liabilities withing the life insurance space.

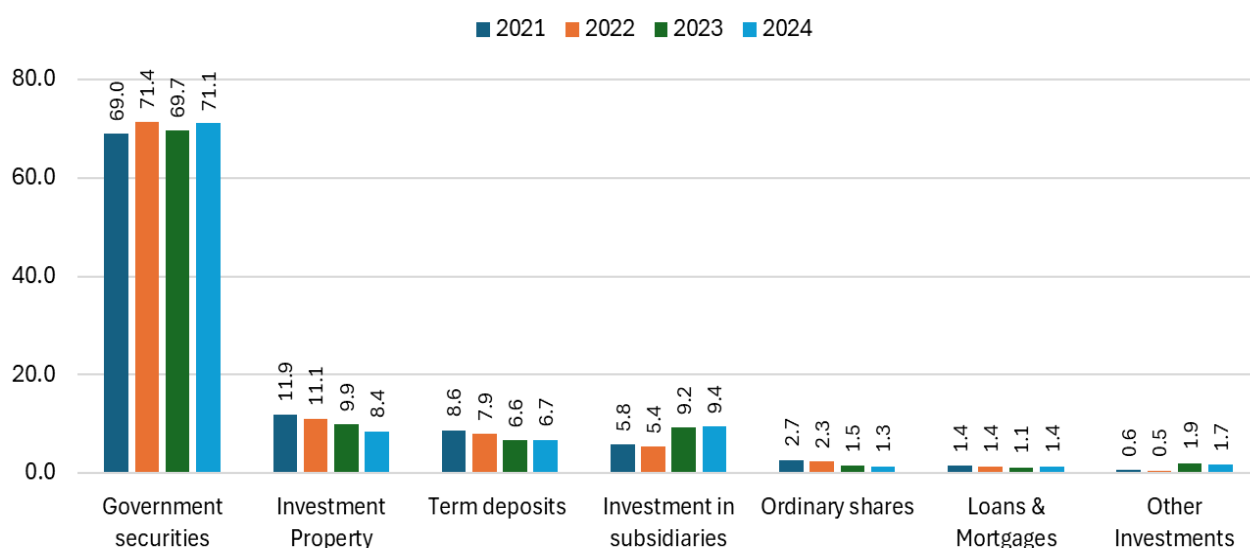
The efficiency of the insurance industry improved as indicated by the decline in the expense ratio to 24 percent in 2024 from 26 percent reported in 2023. The industry also mispriced insurance risks, with the combined

ratio increasing to 107.5 percent from 103.9 percent. However, the risk retention ratio stood at 79 percent indicating a balance approach to insurance risk in relation to reinsurance resulting to insurers maintaining profitability, mitigating volatility in earning and safeguarding their capital.

Investments remain highly concentrated in government securities with an upward trend, accounting for 71 percent of total investments. This was followed by investments in subsidiaries, property and bank deposit at 9.4 percent at 8.4 percent a 6.7 percent, respectively. High interest rates environment

favours skewed assets allocation towards government securities in 2024 and this also explains the higher growth in investment income that supplements premium from policies issued. (Figure 28).

Figure 28: Insurance Sector Assets Class (percent)



Source: IRA

The insurance sector invested 71.1 percent of the total assets in government securities. The investment portfolio is like the portfolio for pension funds, and individual under collective investment schemes. The concentration of assets in government securities although considered safer and of higher returns, they predispose insurance sector to fluctuations in bonds prices. In addition, contagion risk is introduced due to increased interconnectedness between banks, pension, the capital market and insurance sectors, through investment in government securities, which are then traded on the capital markets. The collective investment schemes for individual and institutional investors also invest in about 46 percent of their assets in government securities.

2.2.1. Risks Assessment and Outlook

Fiscal policy threats to insurance uptake -

The insurance industry is likely to experience potential negative effects of the recent tightening of Fiscal policy involving increase in taxation. As a result, the larger segment of the population will experience a decrease in disposable incomes thereby limiting their possible expenditure on insurance products and services. Effectively, potential policyholders may shy away from spending on insurance protection while the existing policyholders may engage in adverse policy actions such as cancellations, surrenders and lapses which negatively affect the sustainability of insurance business in both the short and longer term.

In addition, fiscal policy can lead to slower economic growth as reduced earnings for businesses reduce spending on employee benefits (including health and life insurance) and business insurance coverage (e.g. liability and property).

Market Risk - Insurance entities are exposed to price fluctuations in the stock and capital markets exacerbated by challenging macroeconomic conditions. Depressed stock market prices and performance leads to shrinking of the insurers' balance sheets with liability projections exceeding asset valuations. In addition, falling stock prices result in book losses that impact on the earning potential and profitability of insurance ventures.

Insurers engage in mitigation strategies such as asset-liability management and diversification of investment portfolios to manage their market risk exposures. The regulator, in addition to adoption of risk-based capital requirements that factor in various risk, including market risk in the model calibration, should monitor sector-wide market risk exposures.

Climate Risk & Adaptation - Climate change is increasingly influencing insurance markets due to the rising frequency and severity of weather-related events, regulatory shifts, and broader economic implications. Insurance operations are negatively impacted by increased claims and payouts, higher reinsurance costs and geographic areas becoming uninsurable which may necessitate repricing or withdraw certain insurance products.

Insurers must manage climate related risks through underwriting and product innovation strategies including risk-based pricing, exclusions and coverage limits and new climate-related products.

Cyber Risk - Cyber risk has become one of the largest concerns for insurers, with the increasing frequency and sophistication of cyberattacks. The growth of digital transformation, the widespread use of sophisticated technologies, and the rising value of data and intellectual property make businesses vulnerable to various cyber threats. Some examples here include; data breaches and privacy violations, ransomware attacks, denial of service (DoS) and distributed denial of service (DDoS) attacks, intellectual property theft, third-party vendor risk.

Insurers need to conduct thorough risk assessment and profiling of their IT infrastructure, data protection, and incident response protocols using cyber scoring tools, vulnerability scans, and AI-driven analytics. The regulator should issue cyber-security regulations and guidelines and require insurers to put in place mandatory cybersecurity programs.

(Geo)political Tensions – (Geo)political tensions pose a major emerging risk for the insurance industry with implications across key business processes such as underwriting, reinsurance, investment strategies and global market dynamics. For instance, global uncertainty affects financial markets, interest rates, and inflation.

To mitigate risks arising from (geo)political tensions, (re)insurers continue to employ strategies such as diversification of portfolios, dynamic repricing and re-underwriting, and robust reinsurance programs. The regulator should enhance Collaboration with other foreign supervisors for consistent supervision of global and regional insurers and response to transnational threats.

Contagion Risk - Contagion Risk refers to the possibility that financial distress or failure in one insurer, or one part of the insurance sector, spreads to others potentially threatening the stability of the entire insurance industry or even the broader financial system. Some of the drivers of contagions risk in insurance include interconnectedness through reinsurance and intra-group exposures, common asset exposures, macroeconomic shocks, policyholder behaviour and climate and catastrophe events.

Contagion risk is mitigated through diversification (both geographical region diversification and asset portfolio diversification), reinsurance practices and stress testing and scenario analysis. In addition, insurance supervisors play a critical role in mitigating contagion risk through supervisory oversight and macroprudential regulation as well as imposition of strong capital and liquidity requirements.

Insurance penetration remains relatively low at approximately 2.4 percent, which increases homogeneity in risks and claims. This increases insurance risk mispricing,

resulting to combined ratio to be persistently above 100. Nevertheless, there is a huge potential for growth given the large untapped market for the underserved population and insurance for specialised risks such as infrastructure insurance for large-scale projects in construction, transportation and energy. The Government, through the insurance regulatory and other stakeholders continues to ensure promotion of an enabling environment for the industry players to take exploit this potential. Recently, the Government initiated the process of development of the National Financial Inclusion Strategy that with complement IRA's efforts geared towards driving the 'inclusive insurance' agenda.

2.2.2. Insurance Sector Safety Net

The Policyholders Compensation Fund (PCF) is a State Corporation under The National Treasury & Economic Planning that was established under Section 179 of the Insurance Act (CAP 487, Laws of Kenya) with the primary mandate of compensating policyholders and claimants of insurers that have collapsed. The maximum compensation payable to any policyholder or claimant, as prescribed by law, is Ksh. 250,000 per claim. In addition to its compensation role, PCF is also mandated to monitor the risk profiles of licensed insurers and to participate in statutory management and liquidation processes upon appointment.

PCF collects a contribution levy from both policyholders and insurers at a rate of 0.25 percent of the premium paid by each party (a combined total of 0.5 percent of the premium)

to fund compensation payments and its operations. These contributions are invested primarily in government securities, forming PCF's fund assets.

During the year 2004, PCF commenced compensation for policyholders and claimants of four (4) insurers. Additionally, during the year PCF was the statutory manager of two collapsed insurers whose licenses had been cancelled by the Insurance Regulatory Authority (IRA).

As at the end of the year 2024, PCF's fund assets increased to Ksh. 24.6 billion from the initial seed capital of Ksh. 35 million provided by the government at inception in the year 2005. However, the exposure to the Fund from the insurance industry in terms of total amount of outstanding claim amounted to KShs 134.8 billion while the exposure in terms of the total number of outstanding claims amounted to KSh 180.3 billion. In relation to the size of the fund of KSh 24.6 billion, the industry exposure represented a significant funding gap of KShs 110.3 and KSh 155.7 billion, respectively (**Table 8**).

Table 8: Funding gap for policy holders

Indicator/Year Ended	2021	2022	2023	2024	Annual Change (%) for 2023-2024
PCF Fund Assets (KS Millions)	15,406	17,380	20,675	24,545	19
Fund's Exposure based on Total Amount of Outstanding Claims from Insurance Industry (KSh Millions)	94,825	113,646	118,561	134,822	14
Fund Coverage Ratio (Based on Amount of Outstanding Claims)	16.3	15.3	17.4	18.2	4
Total Number of Outstanding General Insurance Claims	749,608	929,653	1,398,336	993,876	-29
Total Number of Outstanding Long-term Insurance Claims	31,479	34,872	39,566	36,147	-9
Total Number of Outstanding Claims (General & Long-Term Insurance)	781,087	964,525	1,437,902	1,030,023	-28
Fund's Exposure based on Total Number of Outstanding Claims from Insurance Industry (KSh Billions)	136,690	168,792	251,633	180,254	-28
Fund Coverage Ratio (Based on Number of Outstanding Claims)	11.30%	10.30%	8.20%	13.60%	66

Source: PCF

The fund coverage ratio increased from 17.4 percent to 18.2 percent in 2024. However, the coverage ratio is lower than Organisation for Economic Co-operation and Development (OECD) countries. In addition, the Fund assets are not sufficient to cover insured with policies from a systemically important insurance companies in Kenya upto KSh 250, 000 as mandated by the Policyholders Compensation Fund (PCF).

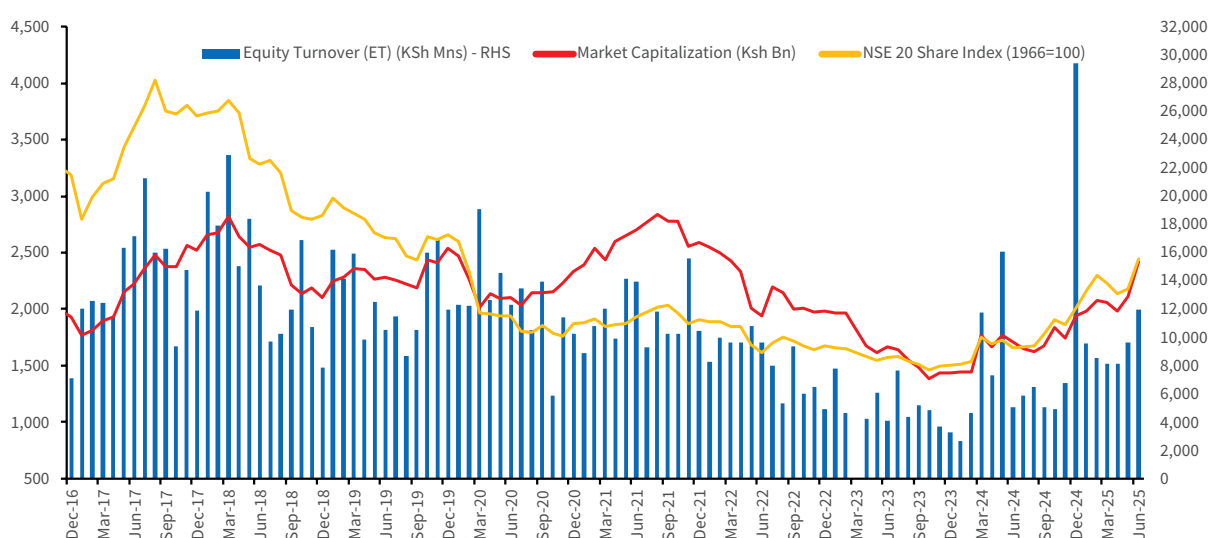
Lack of effective cover not only predisposes the insureds to losses but also reduces confidence in the insurance sector and uptake of insurance services. Insurance business thrives on confidence, which is augmented by the insurers honouring claims and if the insurers are insolvent the insureds are still covered. In addition, the financial

sector is predisposed to contagion risks due to interlinkages between the insurance companies, banks, capital markets, pension funds and Saccos.

2.3 Capital Markets

The performance of the capital market improved in 2024 compared to 2023, mainly driven by profitability of the energy, logistics and insurance and investment companies. The companies were profitable due to decline inflation, appreciation of the Kenya shilling against other currencies, increase in investor confidence. Consequently, the NASI, NSE 20, and market capitalisation increased by 33.9 percent, 34.1 percent, and 34.8 percent, respectively as of December 2024 compared to December 2023 (**Figure 29**).

Figure 29: Select Equities Market Performance Indicators (percent)



Source: NSE data

By end of June 2025, NASI, NSE 20 and market capitalisation increased by 24.3 percent, 21.4 percent, and 24.6 percent, respectively, from their December 2024 level. The total equity turnover and total shares traded also increased by 20.1 percent, and 31.8 percent, respectively in 2024 compared with 2023, implying improvement in the equities market even as global risks persisted. Equity prices of large companies by market capitalisation also increased in 2024 and in the first half 2025. The improvement in the equities market is underpinned by economic recovery, stability in exchange rate, drop in interest rate and inflation.

The liquidity of the equities (sum of equities turnover divided by end year market capitalisation) has maintained downward trajectory since 2015, from 10.7 percent to 5.2 percent in 2024 and June 2025. Implementation of securities lending reforms to spur liquidity by allowing market participants to buy and sell securities not owned by them improved liquidity of equities in 2025. The CMA is in to process of operationalizing the recovery board and the other new market segments as provided in the Capital Markets (Public Offers, Listings and Disclosures) Regulations, 2023, which came into force in December 2023 and establishes two mandatory market segments, including the Main Investment Market Segment (MIMS) and the Small and

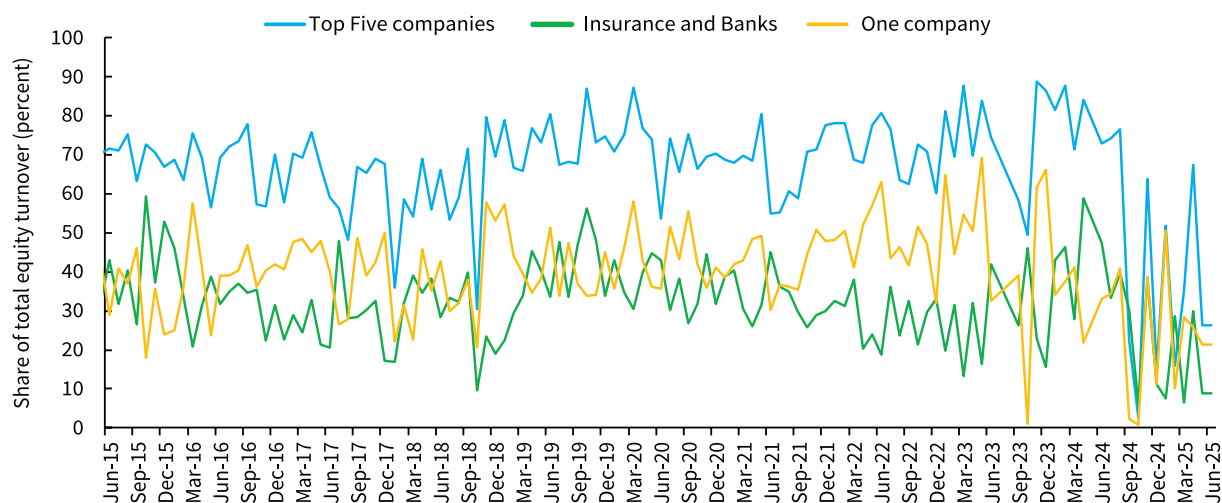
Medium Sized Enterprises Market Segment (SME). The Recovery board is expected to help with the supervision of companies facing financial and governance challenges and also mitigate volatility in their equity prices. This will enhance market integrity, protect investors, and facilitate the rehabilitation of fragile listed.

The inclusion of standard chartered bank and Housing finance company in the Morgan Stanley Capital International (MSCI) enables foreign investors to trade in equities listed on the NSE. This not only increases foreign investor participation, but also liquidity of equities.

The reinstatement of Kenya airways (KQ) share trading on the NSE following withdrawal of privatisation bill and the announcement of profit by KQ will further boost equities market liquidity and vibrance of the equity market.

Market concentration risk remains high, with top five listed firms accounting for an average of 77.7 percent of total equity turnover in 2024 compared to 80.0 percent in 2023. In terms of market capitalisation, the share of top five companies averaged 62.9 percent in 2024 and 67 percent in 2023. This indicates that investors are diversifying their portfolio beyond the blue cheap companies to collective investment schemes, money market fund and SMEs (**Figure 30**).

Figure 30: Market Concentration Risk remains



Source: NSE data

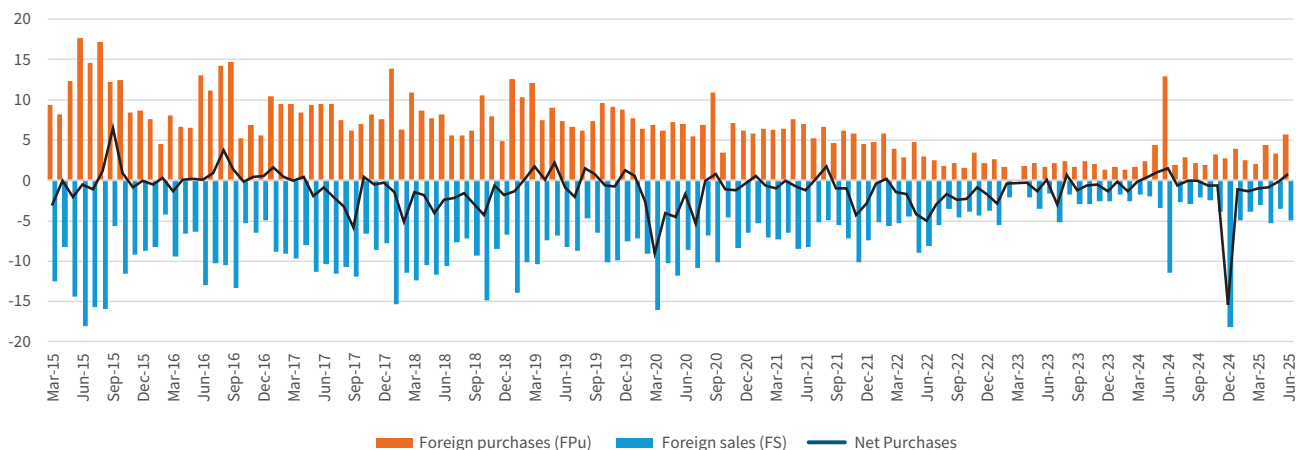
The financials (insurance & banks) accounted for 31.4 percent while Telecommunications (Safaricom only) accounted for 50.0 percent of total equity turnover in 2024. The primary market for equities remained subdued in 2024, with no new listing of shares through Initial Public Offering (IPO), however, Rights Issues activity increased in 2024 after more than 9 years of inactivity. Standard Group, HF Group, Sanlam Kenya and Family bank announced rights issues to boost their balance sheets, finance growth and expansion programmes.

Foreign investors at the Nairobi Securities Exchange (NSE) continued to reduce their portfolio holding 2024 into first half of 2025 contributing to further decline in market activity. More sales than purchases have persisted since March 2020, albeit slight net inflows in September 2020, September 2021 and June 2024. Overall, the market remained

on net outflow in 2024 and first half of 2025, highlighting the impact of rising geopolitical tensions, domestic business environment and firm-specific challenges (**Figure 31**).

The sell-off at the NSE could also be attributed to the tight financial conditions in international markets as geopolitical tensions and tariff wars persist. Also results, of monetary policy tightening in advance economies led to interest rates in advanced and emerging markets have rising sharply, leading to significant increase in interest rate differential between Kenya and the advanced countries interest rates. The increase in interest rate differential motivates investors searching for higher returns to sell equities contributing, hence increased volatility at the NSE.

Figure 31: Foreign Investor Activity at the NSE (percent)



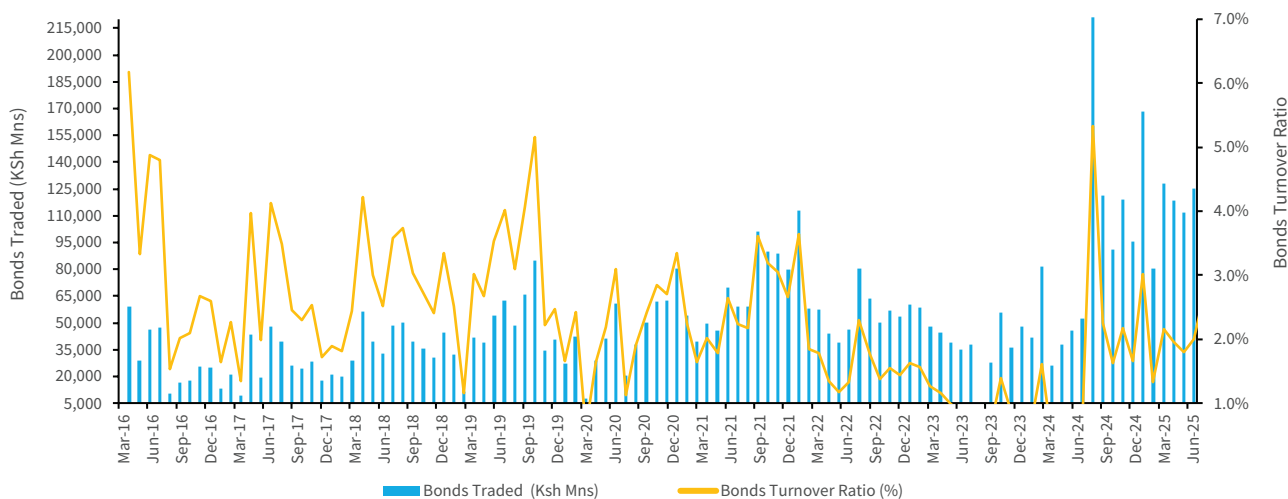
Source: NSE data

Fixed income segment of NSE for corporates remained subdued in 2024.

The corporate bond market did not have any issuances in 2023 and 2024 due to high interest rate on treasury bonds on the primary market. The favourable yields on treasury bonds also suppressed trading in corporate bonds and equities. The bonds traded in the domestic secondary market increased by 139.8 percent from 644.0 KSh billion in 2023 to KSh 1,544.38

billion in 2024, mainly dominated by treasury bonds. A similar strong investor appetite for Government bonds was recorded in the primary market, where most bonds offered were oversubscribed. The yield curve on government securities shifted downwards as interest rate declined in the domestic and international markets, indicating a decline in the cost of borrowing and easing of risks (Figure 32).

Figure 32: Local Currency Bonds Secondary Market Activity

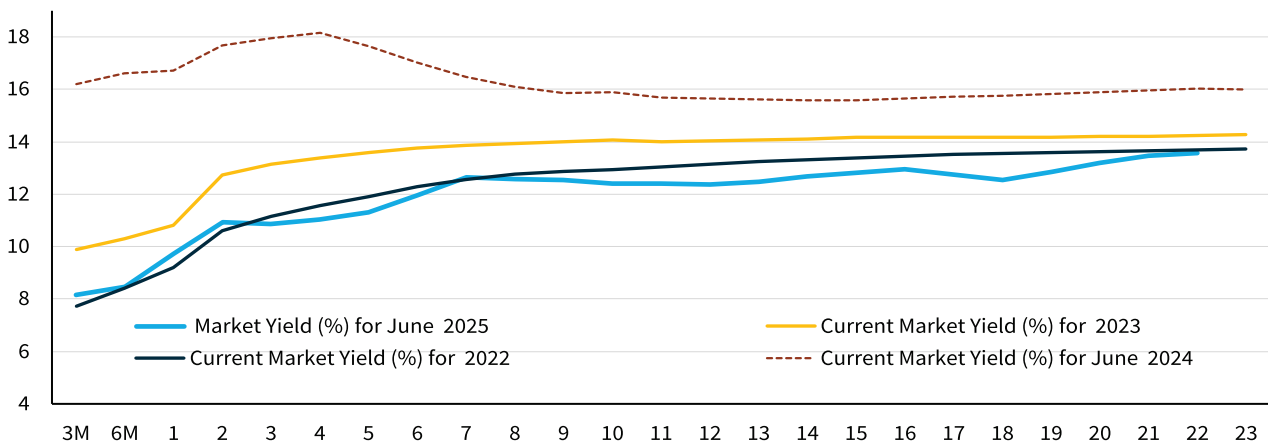


Source: NSE data and CBK datasets

The liquidity of bonds increased in 2024 and the first half of 2025. The ratio of bonds turnover to the face value of outstanding bonds increased from 1.5 percent to 4.9 percent in December

2024 and 3.4 percent in June 2025. This can be attributed to the decline in mark to market losses as result of decline in yields (**Figure 33**).

Figure 33: Yields of Government Bonds (percent)

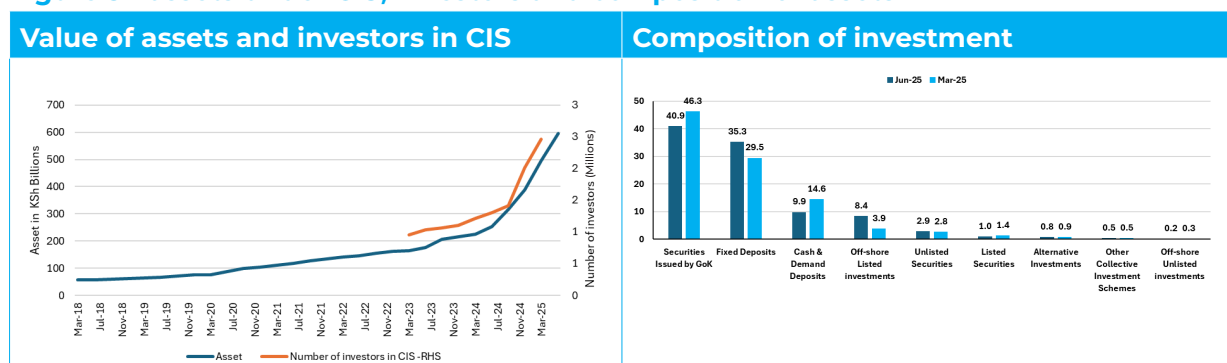


Source: NSE

The collective investment scheme segment recorded significant growth and development due to investors increasingly being aware of the opportunities to save and invest in the capital market, maximise wealth of the group. The CIS have also leveraged on regulatory changes to advance the investment interest of the groups. In 2024, number of investors

under CIS increased by 111 percent percent from 950,020 in March 2023 to 2.1 million, while assets under management increased by 202.6 percent from KSh 164 billion to 496.2 billion (**Figure 34**). The asset are dominated by Kenya government which are predominantly in Kenya shillings.

Figure 34 assets under CIS, Investors and composition of assets



Source: NSE

The concentration of assets in government securities, fixed deposits, cash and demand deposits as indicates that the CIS have lower risk appetite hence preferred as safe assets for capital and liquidity preservation. However, their increasing scale to almost KSh 0.5 trillion in less than 1 year signifies emerging role of Non-Bank Financial Institutions that require closer monitoring to mitigate any potential sources of risks to the rest of the financial sector. However, narrowing fiscal space and compression of interest rate margins in the money market elevate risks and reduces returns to investment compared to investment in equities.

Despite the increase in sovereign risk and market risks as a result of narrowing of interest rate margin due to easing of monetary policy, the distribution of CIS assets is between Money Market, Equity, Fixed Income, Balanced and Special funds. The Money Market Fund and Special Fund accounted for 62.5 percent and 19.0 percent, respectively of the total asset under management. The money market and special fund are the most preferred due to lower risks flexibility in the choices of the investment portfolio. Fixed income funds are also preferred for their flexibility in investment, income from instruments purchased. The equity and balanced fund, are the least preferred even though they generate returns in the longer run and therefore, preferred by investors who have a longer-term perspective of the return on assets. In addition, CIS also foreign denominated assets. The foreign currency denominated funds under an AUM of amount Kshs. 62.0 billion in Q2 2025 representing a market share of 11 percent. Holding foreign

currency denominated mitigates exchange rate risks and eases repatriation of benefits for non-residents. Therefore, the distribution of the asset under management under diverse CIS and holding of foreign denominated assets minimises the risks to the investors.

2.3.1. Trends of key developments and risks

- In 2025, regulatory attention on the crypto ecosystem has been intensified globally. The sentencing of FTX's and Binance's CEOs marked key milestones. Locally, the Capital Markets Authority (CMA) has been collaborating with the Financial Stability Council (FSC) to develop a joint supervisory framework on crypto assets. Progress has also been made towards a potential digital assets sandbox. These steps align with global efforts to safeguard investors and maintain market integrity.
- Digital transformation continued to disrupt capital markets distribution models. There has been a significant growth in the number of mobile platforms offering retail access to unit trusts, equities, and other capital market products. However, investor protection concerns are rising, particularly around influencer-driven marketing on social media, gamified investment apps, and algorithmic recommendations. CMA has issued draft guidelines on digital marketing and suitability standards to address these risks.
- Kenya's leadership in green finance continues to grow. In early 2025, the government issued Africa's first Sovereign Sustainability-Linked Bond, tied to climate and social indicators. The

Nairobi Securities Exchange (NSE) also operationalized a dedicated Sustainability Segment, enabling listing of ESG-aligned instruments. Additionally, green sukuku and blue bonds are under active discussion, widening the sustainable finance toolkit.

- The listed firms increasingly incorporated sustainability disclosures following the adoption of the ISSB's IFRS S1 and S2 standards. Kenya's leadership in green finance continues to position its capital market as a regional ESG hub.
- Full operationalization of the Capital Markets Regulations (Public Offers, Listing and Disclosures), Collective Investment Schemes, Alternative Investment Funds, and Credit Rating Agencies Regulations). The implementation has enhanced regulatory clarity, transparency in product offerings, and investor confidence. A key focus in 2025 has been capacity-building for market participants on compliance with these updated frameworks.

2.3.2. Mitigation measures and embedded Safety nets

1. The Authority continues to promote digital channels, leveraging Kenya's mobile penetration (now at 64.3 million subscriptions as of March 2025) to deepen retail participation. A Fintech Innovation Policy Framework is under development to guide responsible innovation and ensure inclusive access to capital markets products.
2. CMA and industry stakeholders have scaled investor access through digital infrastructure. Fintech partnerships and

API integrations with mobile wallets are enabling real-time onboarding and investment.

3. The Authority launched a revamped Investor Roadshow Series across Gulf countries, the UK, and South Africa to attract portfolio flows. Improved macro stability and debt management helped reverse 2022–2023 outflows.
4. CMA, in partnership with IFC and Nairobi International Financial Centre (NIFC), rolled out the Green Finance Certification Program to build issuer capacity. CMA also issued guidance on ESG ratings and climate-related financial disclosures.
5. The capital markets industry to encourage investors to consider and invest in sustainable finance products such as green bonds and NSE in providing support towards a supporting framework for the issuance of green bonds.

2.3.3. Risks Assessment and Outlook

- Unlicensed digital trading apps and informal investment schemes (e.g., “crypto arbitrage” ventures) remain a threat. CMA is deepening real-time surveillance and public sensitization while enhancing coordination with the DCI, CBK, and CAK to crack down on illegal activity.
- Geopolitical tensions (especially in Eastern Europe and the Red Sea), fluctuating commodity prices, and tight global financial conditions pose downside risks. These can trigger capital outflows and investor risk aversion, affecting local equity and bond market performance.

- Although inflation eased in Q2 2025 due to favorable weather and reduced energy costs, disposable income for retail investors remains constrained. Uptake of long-term capital market products remains sluggish among low-income households.
- Cybersecurity threats and data privacy breaches remain material risks as the capital markets sector becomes more digital. The CMA, together with the National KE-CIRT, issued updated cybersecurity guidelines in 2025 and requires all licensed intermediaries to conduct annual cybersecurity stress tests.
- While the Nairobi Securities Exchange recorded increased turnover following the 2025 Eurobond issuance and investor return, liquidity remains concentrated in a few blue-chip counters. Efforts to deepen liquidity through market-making, ETF development, and securitization frameworks are ongoing
- Increased frequency of climate-induced shocks (floods and prolonged droughts) continues to disrupt businesses and livelihoods, impacting the performance of climate-vulnerable sectors such as agriculture and tourism. This underlines the urgency for climate-resilient investment structures.
- The CMA, NSE, CDSC, and KASIB officially rolled out the Joint Capital Markets Digitization Strategy (2025–2028), focusing on open APIs, real-time reporting, and digital onboarding. The initiative aims to drive market efficiency and broaden participation across counties.

2.4 Pensions Sector

The total retirement benefits assets grew by 30.71 percent, to KSh. 2,255.30 billion as of December 2024. This growth was driven by an increase in both member contributions and investment income. The rise in contributions is largely attributed to the enhanced NSSF contributions, which entered the third year of implementation, raising the lower limit from KSh. 6,000 to KSh. 7,000 and the upper limit from KSh. 18,000 to KSh. 36,000.

The increased contributions provided more funds for investment, contributing to positive growth in government securities, quoted equities, guaranteed funds, immovable property, and offshore investments. However, listed corporate bonds, immovable property, and cash holdings recorded negative growth of 11.1 percent, 5.5 percent, and 0.26 percent respectively.

Allocation of investment assets saw a further shift towards fixed income assets such as government securities, guaranteed funds and fixed deposits. This is reflected in schemes investing significantly more in government securities and guaranteed funds, motivated by increased returns in the asset classes over the period.

Government securities remained the dominant investment class, accounting for 52.5 percent of total assets under management. This was followed by guaranteed funds at 19.4 percent, immovable property at 11.0 percent, and quoted equities at 9.0 percent.

Table 9: Pension Sector Assets Allocation

Assets Class	2016		2017		2018		2019		2020		2021		2022		2023		2024	
	Kshs. (Bn)	%	Kshs. (Bn)	%	Kshs. (Bn)	%	Kshs. (Bn)	%	Kshs. (Bn)	%	Kshs. (Bn)	%	Kshs. (Bn)	%	Kshs. (Bn)	%	Kshs. (Bn)	%
Government Securities	349.2	38.3	394.2	36.5	423.7	36.3	545.3	41.9	625.7	44.7	707.0	45.7	722.0	45.8	818.9	47.5	1,183.3	52.5
Quoted Equities	159.1	17.4	210.2	19.5	241.5	20.7	228.1	17.5	218.1	15.6	254.6	16.5	215.2	13.7	145.1	8.4	202.3	9.0
Immovable Property	178.4	19.6	226.7	21.0	229.3	19.7	239.7	18.4	251.3	18.0	254.5	16.5	248.4	15.8	242.1	14.0	249.2	11.1
Guaranteed Funds	129.6	14.2	143.0	13.2	159.6	13.7	201.5	15.5	230.6	16.5	259.8	16.8	298.0	18.9	358.1	20.8	437.5	19.4
Listed Corporate Bonds	47.0	5.1	42.0	3.9	41.5	3.6	17.8	1.7	5.3	0.4	6.8	0.4	7.8	0.5	6.6	0.4	6.3	0.3
Fixed Deposits	24.6	2.7	32.9	3.0	31.6	2.7	39.4	3.0	39.0	2.8	27.9	1.8	42.2	2.7	81.9	4.7	53.7	2.4
Offshore	7.0	0.8	12.8	1.2	15.0	1.3	6.3	0.5	11.4	0.8	19.4	1.3	14.1	0.9	27.2	1.6	64.5	2.9
Cash	12.9	1.4	13.0	1.2	19.0	1.6	15.0	1.2	12.2	0.9	9.5	0.6	16.8	1.1	25.0	1.4	23.1	1.0
Unquoted Equities	4.0	0.4	4.1	0.4	3.8	0.3	3.6	0.3	3.4	0.2	3.5	0.2	5.0	0.3	3.6	0.2	4.0	0.2
Private Equity	0.2	0.0	0.3	0.0	0.4	0.0	1.0	0.1	1.7	0.1	3.0	0.2	3.6	0.2	5.7	0.3	16.2	0.7
REITS	0.8	0.1	1.0	0.1	1.0	0.1	0.5	0.0	0.3	0.0	0.4	0.0	0.3	0.0	11.1	0.6	11.7	0.5
Commercial Paper, Non-listed bonds & Others			0.1	0.0	0.2	0.0	0.1	-	0.0	-	1.1	0.1	2.7	0.2	0.02	0.001	3.20	0.1
Any Other Assets																	0.2	0.0
TOTAL	912.64	100.00	1,080.15	100.00	1,166.49	100.00	1,298.29	100.00	1,398.96	100.00	1,547.43	100.00	1,576.21	100.00	1,725.44	100.00	2,255.20	100.00
Overall Risk Score		0.52		0.51		3.07		3.10		3.15		2.98		2.96		2.94		2.67

Source: RBA data

2.4.1. Key Risks and Mitigation Measures

The pension subsector is faced with the following risks:

i. Funding Risks: The risk manifests through underfunding in defined benefits schemes and unremitted contributions in defined contribution schemes. As at 30th March 2025, the average funding level of the fifty three (53) registered DB schemes was one hundred and two percent (102percent). However, twenty-seven (27) schemes reported a funding level which was below the required minimum funding level of DB schemes of one hundred percent (100percent) and total actuarial deficit of Kshs 56.5 billion. In addition, the total unremitted contribution as at 31st December 2024 was Kshs 60.7 billion which was apportioned between public and private sectors in the ratios of ninety-

six percent (96percent) and four percent (4percent) respectively.

ii. Concentration risk – Over 92percent of pension assets have invested in just four asset classes, despite the Retirement Benefits Authority (RBA) providing more than 15 approved investment avenues. This high concentration exposes the pension sector to significant vulnerability, as shocks in any of the four asset classes could have a widespread and pronounced impact across the industry.

iii. Legal and Regulatory Risks: Frequent changes in the legal and regulatory framework governing the retirement benefits sector may affect the sustainability of the sector.

iv. Operational Risks: Most of the retirement benefits schemes are small and may not have adequate internal controls, systems and resources to adequately manage the pension scheme assets.

v. Agency Risk: The retirement benefits sector has outsourced most of its services including administration, custodial and fund management. This therefore poses a risk to the sector due either to excessive fees or conflict of interest among the players.

vi. Demographic Risk - The retirement benefits sector has low coverage among informal sector workers, leaving a significant portion of the population without pension protection. This increases the risk of old-age poverty and places future pressure on social support systems as these individuals retire without adequate savings.

2.4.2. Mitigation Measures

- **Diversification of investments:** The investment assets classes have been expanded to 15 asset classes to accommodate alternative assets. The investment limits have been provided to guard against over-exposure and concentration risks.
- **Review of the regulatory framework:** The regulatory framework is reviewed regularly to capture emerging issues and incorporate new and innovative products.
- **Innovation in the subsector:** The subsector encourages new ideas and innovative products targeting the under covered population in the informal sector. The new

products includes the hustler fund saving component which is a bundled product which consist of the credit facility and savings facility for both short term and long term purposes.

- **Consumer Protection:** Development of guidelines to ensure good governance in schemes and protection of members' and sponsors' interest. In this regard the sector is implementing the governance guidelines and the treating customer fairly guidelines.
- **Aggregation of Schemes –** The Retirement Benefits Authority (RBA) has introduced provisions for the establishment of umbrella schemes, allowing small employers to join collective schemes rather than setting up individual ones. This approach reduces administrative costs, enhances compliance, and improves efficiency in scheme management.

2.4.3. Future Outlook of pensions

The retirement benefits assets are expected to grow over the coming period driven by member contributions, especially with the increase in contributions to NSSF, with the continued implementation of the NSSF Act 2013, which gradually increases employer and employee contributions. In addition, investment income from fixed income investments income where most schemes have invested their funds, is expected to further fuel this growth. Lastly, the rebound of the stock markets is also expected to further boost growth, especially for schemes that have substantial investments in listed equities.

2.5 Sacco Sector

The growth momentum of Savings and Credit Cooperatives (Sacco) Societies continued in 2024. The number of licensed SACCOs was 358 SACCOs consisting of 177 deposit-taking and 181 non-withdrawable deposit-taking in 2023 and 2024. The total assets increased by 10.1 percent between in 2023 and 2024, mainly driven by growth in gross loans. The SACCOs sector was able to attract deposit from members, which increased by 10.7 percent, providing a stable funding base for loans (Table 10).

Table 10: Sector Key Indicators for Deposits Taking SACCOs (KSh Million)

(Quarter/Year) Figures in KSh. 000											
	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	Sep-23	Dec-23	Dec-24	Change 2024/2023
Total Assets	392.8	441.8	497.3	555.9	630.9	700.3	764.2	940.6	981.5	1080.9	10.1
Gross Loans	291.4	331.3	373.2	420.5	474.7	523.0	586.0	737.9	759.0	842.8	11.0
Total Deposits	272.4	307.0	342.3	381.1	431.1	473.3	522.4	660.9	677.8	750.6	10.7
Core Capital	58.1	66.8	78.3	95.1	100.4	119.6	142.3	159.1	162.3	188.7	16.3
Institutional Capital	34.0	38.8	46.3	59.3	59.8	73.6	90.6	100.8	104.0	129.9	24.9
External Borrowings	20.2	21.8	22.2	22.1	23.5	24.8	24.3	28.0	26.8	25.2	(5.9)
Earning Assets	313.5	357.0	403.8	455.6	517.0	567.4	574.4	814.7	838.7	927.1	10.5
Liquid Assets	40.3	47.1	55.2	67.7	85.8	105.9	108.0	99.7	126.5	155.9	23.2
Non-Performing Loans	14.8	19.9	22.9	25.9	32.9	35.4	48.4	50.4	44.4	53.1	19.7
Provisions for loan losses	8.9	11.2	14.6	18.6	23.9	26.2	37.5	44.0	43.8	55.5	26.6
Gross Income	52.6	60.7	69.3	80.2	84.5	96.5	105.6	103.6	140.9	159.6	13.3
Operating Expenses	18.3	20.7	23.1	25.7	26.9	31.5	36.0	31.9	43.9	48.4	10.2
Net Interest margin	29.0	33.0	41.7	44.1	48.9	58.0	62.8	58.3	76.5	83.8	9.5
Short term Liabilities	79.4	86.8	100.2	133.2	121.2	138.6	147.3	155.7	176.4	192.9	9.4
Net Financial Income	31.4	36.1	41.7	47.5	52.0	59.4	66.4	64.9	85.1	94.6	11.2

Source: SASRA

The expansion of asset relative to expenses resulted to slow growth in profit as of December 2024. Return on assets decreased from 9.7 percent in 2023 to 9.2 percent in 2024. This is on account of slower growth in net interest income compared to growth in assets.

The sector's Financial Soundness Indicators (FSIs) were strong in December 2024 (Table 11) core capital to total assets and institutional

capital to total assets improved from 16.5 percent and 11.9 percent to 17.5 percent to 12.0 percent. The ratios were above the minimum regulatory requirement. This enables SACCOs to intermediate funds effectively. The quality of assets deteriorated with NPLs to Gross loans increasing to 6.3 percent. Provision for NPLs increased by 26.6 percent compared to the growth rate of NPLs which declined by 19.7 percent.

In addition, liquidity ratio stood at 80.8 percent, which is above the regulatory requirement of greater than 15 percent. This enabled SACCOs to meet their short-term liabilities, while maintaining adequate buffers against liquidity shocks. The soundness and stability of SACCOs enabled them to effectively intermediate funds and improve profitability.

Table 11: Financial Soundness Indicators (FSIs)

Sector/FSI/(Quarter/Year)	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	Dec-23	Dec-24
Core Capital	58,135	66,825	78,267	95,128	100,381	119,557	142,325	162,273	188,731
Core Capital/Total Assets	14.8	15.1	15.7	17.1	15.9	17.1	18.6	16.5	17.5
Core Capital/Total Deposits	21.3	21.8	22.9	25.0	23.3	25.3	27.2	23.9	25.1
Institutional Capital/Total Assets	8.7	8.8	9.3	10.7	9.5	10.5	11.9	10.6	12.0
Non-performing loans/Gross Loans	5.1	6.0	6.1	6.2	6.9	6.8	8.3	5.8	6.3
(Non-performing loans-Provisions)/Core Capital	10.1	13.0	10.6	7.7	9.0	7.7	7.7	0.3	-1.3
Earning Assets/Total Assets	79.8	80.8	81.2	82.0	81.9	81.0	75.2	85.5	85.8
Return on Assets	0.0	8.7	8.9	9.0	8.8	8.9	9.1	9.7	9.2
Cost Income ratio	58.1	57.3	55.3	54.2	51.7	53.1	54.2	51.6	51.1
Net Interest margin	0.0	7.9	8.9	8.4	8.2	8.7	8.6	8.8	8.1
Operating expense ratio	0.0	5.0	4.9	4.9	4.5	4.7	4.9	8.9	4.7
Liquidity ratio	50.8	54.2	55.1	50.8	70.8	76.4	73.3	71.8	80.8
Liquid Assets/Total Assets	10.3	10.7	11.1	12.2	13.6	15.1	14.1	12.9	14.4
Liquid Assets/Total Deposit liabilities	14.8	15.3	16.1	17.8	19.9	22.4	20.7	18.7	20.8
External Borrowings/Total Assets	5.1	4.9	4.5	4.0	3.7	3.5	3.2	2.7	2.3
Total Gross Loans/Total Deposits	107.0	107.9	109.0	110.4	110.1	110.5	112.2	112.0	112.3

Source: SASRA

2.5.1. The Challenges faced by a Secondary Sacco

The SACCO Societies Act, 2008 and its attendant regulations 2010 and 2020 were formulated focusing on regulation of primary cooperatives which are owned by natural persons. Primary Cooperatives are formed to meet their members social-economic needs and may include housing, consumer, marketing, transport among others. The existing legal and regulatory framework primarily focuses on the soundness and stability of the regulated SACCOs by emphasizing on capital, liquidity, quality of earning assets, strengthening

governance structures through licensing, regular reporting, inspections and corporate approvals.

Besides these primary Saccos, there exists Secondary Saccos whose memberships are restricted to two or more primary Saccos. They are registered under the Cooperative Societies Act to offer services to primary Saccos especially advocacy and other shared services. However, there is a trend where such secondary Saccos engaged in deposit taking businesses through a Central Finance Fund products modelled as an investment option for

savings and a source of accessing liquidity for the SACCOs taking advantage of the existing legal gap.

The concept of Secondary SACCO Societies in Kenya is therefore an offshoot of the universal national vertical organisation of Cooperatives worldwide consisting of an Apex Cooperative at the top of the vertex, followed by Tertiary Cooperatives and Secondary Cooperatives at the middle of the vertex, and Primary Cooperatives at the bottom of the vertex.

Cooperatives including regulated SACCOs own secondary societies with whom they used to access various products and services. Such included trainings, investments in form of deposits, provision of loans to support operations, insurance services among others. The secondary society experienced financial difficulties leading to its insolvency.

In the recent past, the market witnessed the effect of mismanagement at the Secondary Cooperative leading to financial losses by the regulated SACCOs which had placed their funds either in the form of shares amounting to Ksh. 3.1 billion translating to 1.64 percent of core capital. On the other hand, total deposits held by the regulated SACCOs amounted to Ksh. 13.82 billion translating to 7.32 percent of core capital and 1.84 percent of total deposit liabilities against the legal requirement of 40 percent which Saccos can place in non-government securities. Member primary Cooperatives including regulated SACCOs were unable to access loans and savings, principal investments and interest on term deposits held with the Secondary Cooperative.

The Authority considered and processed three (3) license certificates for non-withdrawable deposit taking SACCOs that transited to deposit taking category during the year. This has been occasioned by the increasing demand from members of the non-withdrawable deposit taking SACCOs innovative products and services such as operation of transactional accounts, payment services and channels. which are essentially offered by Deposit Taking SACCO. Consequently, the number of DT-SACCOs increased to 177 in 2024 from 174 DT-SACCOs in 2023, while NWDT-SACCOs were 180 in 2024 and 183 in 2023. Four (4) NWDTs had submitted application for consideration to undertake DT-SACCO business by the end of the calendar year of which three (3) were considered and approved.

2.5.2. Key Developments and Risks

In line with prudence principle and the need to ensure compliance with Accounting Standards, regulated SACCOs were directed by the Authority to recognize impairment losses in their financial statements specifically for the deposits held with KUSCCO. Earlier recognition of impairment losses was recommended in the SACCO financial statements. This is aimed at ensuring correct accounting for Sacco assets to avoid overstating of assets whose recoverability are uncertain.

The Kenya Union of Savings and Credit Co-operatives Ltd KUSCCO is the apex body serving Kenya's SACCOs and also had KUSCCO Housing Corporation, KUSCCO Mutual Assurance and SACCO Liquidity Fund as subsidiaries. KUSCCO mobilised large deposits from member

SACCOs and invested the deposit in property, government securities and loans to members, non-member SACCOs and individuals. The lending activities of KUSCCOs enable SACCOs facing liquidity constraint to access affordable liquidity and to sustain lending, pay dividends, reduce reliance of member SACCOs on commercial banks borrowings to finance the loans to members.

As of December 2023, KUSCCOs had KSh 12.5 billion in asset, KSh 17.7 liabilities. In 2025, the assets declined to KSh 5.2 billion against liabilities of KSh 17.7 billion. The assets included KSh 1.33 billion in loans to dormant saccoes and KSh 9.3 billion in overstated incomes from a fraudulent scheme, while KSh 206 million in cash of member funds was lost. In 2024/2025 equity declined from KSh 17.7 billion to negative 12.5 billion, resulting to aggregate loss of KSh 13.3–14.0 billion based on the 2024/25 forensic/audit findings. Deposit mobilized from about 247–257 SACCOs were also lost, with 201 SACCOs reported a 10% erosion of core capital owing to KUSCCO exposure. The dividends for SACCO members declined, while provisioning increased to cater for losses, the retail & MSME borrowers faced tighter credit conditions.

The deposit mobilization and investment activities increased inter SACCO exposure through deposits and loans. As a result, the solvency of KUSCCO affected the SACCO sector due to contagion emanating from deposits, loans, and inability of SACCOs to obtain liquidity within the sector. In addition, the KUSCCO shock was also transmitted to insurance, money and housing markets due to

interlinkages created by its assurance, housing and asset management subsidiaries.

The cooperative societies is generally stable and resilient to shocks especially with the establishment of SASRA and amendment to the Cooperatives Societies Act, which strengthened legal and regulatory frameworks for societies. However, structural changes in the economy that demand innovation the cooperative societies to meet member needs lead to the formation of cooperative societies with SACCOs products. This required reforms in the regulatory framework to regulate the entities that operate as cooperative societies as well as SACCOs. KUSCCO is one of the societies registered under the cooperative societies Act and hence regulated by commissioner of cooperative societies but conducting financial intermediation. This created regulatory arbitrage whereby by KUSCCO mobilized deposit and extended loans without adhering to the prudential requirement of a deposit taking SACCO.

The regulatory framework for cooperative societies encouraged weak governance, misconducted and inaccurate reporting and falsification of reports, which were undetected. This was perpetuated as a result of lack of effective offsite and on-site inspection. The onsite and offsite surveillance could have detected asset overstatements, diversion of funds, forged signatures, irregular withdrawals and fraud. In addition, the persistence of fraud in KUSCCO indicates that the internal audit was weak or was weakened strategically to facilitate, theft, fraud and misreporting.

The interlinkages between KUSCCO other saccos, insurance, capital market and the real estate increases contagion risks, which undermines growth and development of the cooperative, DT- SACCOS and financial system if not resolved in an orderly manner. The resolution of KUSCCO started with forensic audit to establish the losses, exposures, trace assets and identify regulatory gaps. The KUSCCOs has identified KSh 1.36 billion targeted them for recovery, which is less than KSh 14 billion of liabilities. The deposit guarantee fund in its current form is insufficient to ameliorate losses and has no resolution powers. Therefore, to effectively resolve KUSCCOs, there is need for Deposit Guarantee Fund and SASRA has to be strengthened by enhancing there resolution powers including early intervention and mergers.

The SACCOS facing liquidity problems as result of exposure to KUSCCOs may require temporary liquidity back stops from commercial banks, other SACCOS, or Government if they recognized losses and filed credible recapitalization plans.

There SACCOS sectors thrives on confidence of members, which enables them to increase deposit, borrow and repay. A loss of confidence as a result of loss of deposit in KUSCCOs may trigger withdrawal of deposit and loan delinquency. Therefore, coordinated provision of information on exposure, impairment, post shock capital and of the status of resolution of KUSCCO by SASRA and commissioner for insurance will instil confidence in the SACCOS

sector and encourage members to continue saving in Sacco's and repay loans.

The recovery process includes allocation & recapitalization following Standardised IFRS-9 treatment with conservative collateral haircuts across all SACCOS. Paying KUSCCO creditors by adhering to creditor hierarchy to maximise secured recoveries/auctions; negotiate time-bound compositions with viable debtor SACCOS; and converting a portion of residual claims into long-dated loss-absorption instruments at KUSCCO (if it's to be kept as a utility), otherwise liquidate.

Recapitalization of affected SACCOS through retained-earnings, member capital calls capped by affordability, targeted mergers for sub-scale entities, and temporary regulatory forbearance limited to well-documented plans with clear sunset dates).

In the long term legal and regulatory changes are required to close the regulatory gaps that facilitate or can exploited to this include placing all apex /wholesale intermediation (including KUSCCO-type activities) under SASRA's Tiered Prudential Code with explicit capital, liquidity, large-exposure, and related-party limits; end dual-licensing ambiguity. Review resolution law to enable DGF and SASRA deploy early intervention triggers, mergers, purchase & assumption, bridge-entity powers, and statutory vetting to establish fit-and-proper for directors, senior management and external auditors. The vetting powers should also have provisions to remove directors.

DGF operationalisation: fund size, premium-setting, coverage limits, payout timelines, and integration with SASRA's ladder of intervention — to protect small members without creating moral hazard. Mandatory disclosure and reporting quarterly exposure templates for any SACCO investment outside regulated banks/funds; centralized exposure registry at SASRA. SASRA to monitor sharp increases in withdrawals at the most-exposed SACCOs, capital ratios for SACCOs drifting toward minimum post-provisioning. monthly cash proceeds from auctions/enforcement against plan to inform timely intervention.

To instil discipline and to ensure prudence in the declaration of dividend and Interest on members' savings, the regulated SACCOs were further reminded by the office of Commissioner for Cooperative Development through a circular to pay interest on deposits and dividend from generated and supported reserves in the year. This excluded unsupported term deposits held at the secondary society.

2.5.3. Risks, Mitigations and Outlook

Provision of financial services by regulated SACCOs, like other financial institutions, are exposed to a myriad of risks including but not limited to cybersecurity, credit, financial, market, and governance risks among others. Regulated Saccos continue to develop and implement strategies to mitigate these risks. During the period under review, the Authority implemented several strategies to improve the resilience and stability of the industry taking into consideration the emerging risks. These included the issuance of circulars & guidelines

on cybersecurity during festive season, and capacity-building initiatives in collaboration with other Government Agencies. The key risks within the industry are highlighted below;

i. Liquidity risks

Regulated SACCOs have prescribed asset classes through which they could invest their retentions. Such include Government securities, commercial papers, fixed deposits and equity investments in other institutions. Regulated SACCOs were placing their retentions in KUSCCO in order to generate additional incomes as well as facilitate inter-lending. Where such investments were made as term deposits, were considered as part of near cash for purposes of liquidity computation.

The regulatory framework prescribes the various asset classes through which regulated SACCOs can invest their excess reserves. These includes government securities, shares and stocks, deposits in institutions licensed under the banking Act and licensed SACCO societies. This approach has the intended consequences of promoting market confidence and enforcing redress mechanisms in case of business failure.

ii. Un-Regulated Secondary Cooperatives

The enabling legal and regulatory framework for SACCOs in Kenya targeted primary Cooperatives which are member owned or natural persons financial cooperatives. Such financial cooperatives are regulated by the Authority with defined entry criteria. Other financial cooperatives are supervised by the Commissioner for Cooperatives at specific County Governments.

On the other hand, secondary cooperatives which are owned by primary cooperatives operate as self-regulating entities and conduct deposit taking business. The legal lacuna has led to unsuspecting members of the public investing their funds with them and occasionally leading to loss of funds.

iii. Credit Risks

Regulated SACCOs facilitated KShs 842.8 billion in terms of loans and advances which constituted 77.98percent of total assets in gross terms. Overall non-performing loans ratio was 6.3percent, which was marginal increase of 0.45percent from 5.85percent reported in 2023. Major deterioration was in the NWDTS category which grew from 6.90percent to 7.44percent. On the other hand, DTS NPL was 6.15percent from 5.67percent reported the previous year.

The Authority has been advising regulated SACCOs to adopt secure lending practices including perfection of securities to reduce default risk. However, in cases of delayed remittances from employers, the Authority has been assisting regulated SACCOs with the support of the Office of Commissioner for Cooperative Development on the follow up of remittances.

2.5.4. Safety net

The Authority has regularly been cautioning members of the public including regulated SACCOs to restrict their business deals with licensed and regulated entities. Additionally, regulated SACCOs have been restricted to limit their business to core activities to guarantee their financial soundness and continued operations. The operationalisation of the Deposit Guarantee Fund will further enhance the protection of member deposits.

3. FINANCIAL MARKETS INFRASTRUCTURE DEVELOPMENTS AND RISKS

This chapter presents reviews performance and risks outlook in the financial markets' infrastructure, covering retail and wholesale (systemically important) national payments and settlements systems, and regional payments and settlement systems. The recent transformative innovation in the Kenya's government securities market, which culminated in the upgrade of the central securities depository to *Dhow* Central Securities Depository (*Dhow* CSD), has also been incorporated. The Chapter also provides a high-level summary of public participation on the Central Bank Digital Currency (CBDC) and ends with risks outlook.

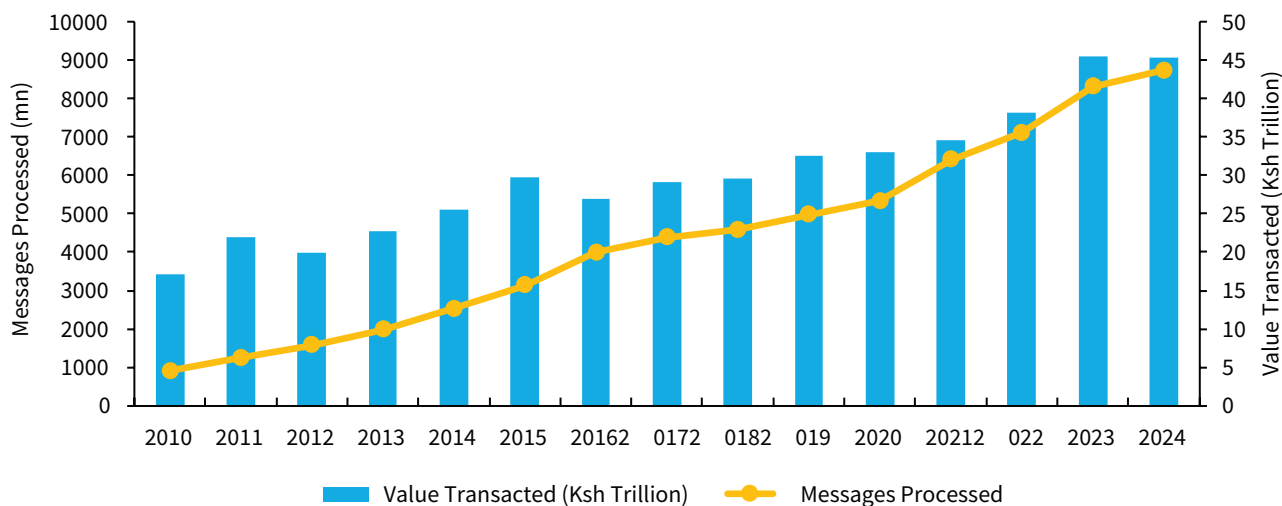
3.1. Payments and Settlement Systems

The Central Bank of Kenya is mandated by National Payments Act 2012 to formulate and implement such policies as best to foster the establishment, regulation, and supervision of efficient and effective payment, clearing and settlement systems. Kenya's National Payment System comprises of; large-value payment system or the Real Time Gross Settlement (RTGS) system, also known as Kenya Electronic Payment and Settlement System (KEPSS); low-value (retail) payment system (mobile money, cards, electronic funds transfers (EFT) and cheques); and regional payments system. The latter clears and settles through the links established by EAC and COMESA central banks with KEPSS.

Overall, the national payment systems continued to play its pivotal role of facilitating transactions efficiently and effectively in 2024. This has contributed to enhanced trust and confidence among users, which is critical in supporting the economy. The fast changing consumer behaviour on account of demographic dynamics and technological revolution contributed to rapid growth in digital financial innovations traversing the health, agriculture, education, and transport sectors. This further highlights the significant role developing an efficient and stable digitalised economy envisaged under economic pillar of Vision 2030.

Kenya's Real Time Gross Settlement (RTGS) system, which is the country's systemically Important Payment System processed 8.7 million transaction messages worth KSh. 45.3 trillion in 2024 (Figure 35). This was above 8.3 million messages worth KSh. 45.5 in 2023. The performance indicates continuous improvement in operational efficiency of KEPSS that guarantees speed, security, and reliability.

Figure 35: Volume and Value Transacted Through KEPSS



Source: CBK National Payments Data

3.1.1. Key risks for KEPSS in 2024

Settlement risk: The growth in the values and volumes processed through the RTGS system requires stronger oversight to ensure appropriate measures are put in place to mitigate potential risks, such as fraud related to endpoint security and liquidity risk. These are critical for effective settlement of obligations and enhancing confidence among users of finality and irrevocability of payment instructions.

Systemic Risk: KEPSS operations and settlements serve highly interconnected participants, thus a potential source of systemic risk. The ability to settle transactions by counterparties underpins the smooth functioning of the KEPSS. The CBK reviews its mitigating measures including provision of intraday liquidity facility to minimise counter party risks.

To align KEPSS platform to best practices, Kenya's payments industry commenced transition to new transaction messages formats – ISO 20022. This is a common, global and end-to-end standard that is expected to standardise communication, enhance data quality and customer experience. It is also aimed at enhancing security and governance of the messages. The process of migrating KEPSS platform to ISO 20022 compliance is to be completed by end of 2024.

3.2. Regional Cross-border Payments Systems

Kenya's regional interconnectedness through trade led to the need for a well-functioning Regional Payment and Settlement Systems to facilitate cross-border payments and settlements. Transactions settled through the East African Community (EAC) Payment and Settlement

System (EAPSS) in 2024 compared to 2023. The number of messages through EAPSS increased by 9 percent, while value of transactions by 37.7 percent in 2024 (**Table 11**).

Table 12: Transactions via Regional Payments Systems

TRANSACTIONS SETTLED VIA REPSS					TRANSACTIONS SETTLED VIA EAPSS						
Year	Value (USD Million)	Volume	Value (EURO)	Volume		Volume			Value (USD Million)		
					Year	Inward	Outward	Total	Inward	Outward	Total
2020	76.04	910.00	401,562.00	4.00	2020	9,867.00	18,544.00	28,411.00	221.95	234.12	456.07
2021	90.70	1,260.00	480,500.29	23.00	2021	10,763.00	23,179.00	33,942.00	300.09	298.76	598.85
2022	106.49	1,426.00	628,998.00	18.00	2022	15,249.00	28,803.00	44,052.00	407.17	415.73	822.90
2023	111.00	1,586.00	876,310.00	11.00	2023	15,609.00	20,907.00	36,516.00	449.00	456.00	905.00
2024	98.21	1,333.00	101,644.43	20.00	2024	18,529.00	21,261.00	39,790.00	622.00	624.00	1,246.00

Source: CBK

Like the EAPSS, the Common Market for Eastern and Southern Africa (COMESA) Regional Electronic Payment and Settlement System (REPSS) continue to record steady growth since operationalization in 2019. The number of messages processed increased from 914 in 2020 to 1353 in 2024, while the value of transactions settled increased from Euros 401,562 to Euros 101, 644 during the period. The USA dollar value of transaction settled increased from USD 76.0 million in 2020 to USD 98.2 million in 2024. The steady growth indicates increasing integration and cross-border trade in the EAC and COMESA region. The stability of these regional payments infrastructure is therefore critical for supporting international trade, integrating economies and deepening financial systems.

Intra Africa trade constitute about 60 percent of Kenya's exports and imports.

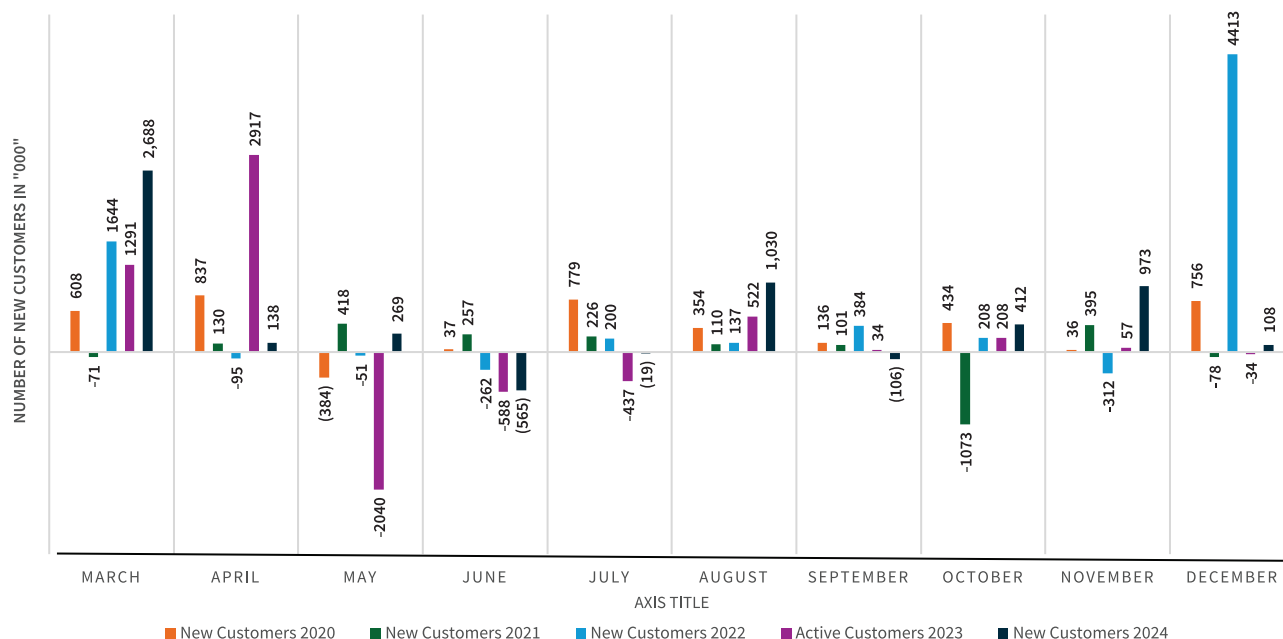
There is also a potential of increasing Kenya's exports to African continent more than 60 percent, especially with signing of African Continental Free Trade Area (AfCFTA). The Pan-African Payment and Settlement System (PAPSS) established in 2021 is one of the catalyst for increasing intra Africa trade by removing bottlenecks in payment for goods and services for retailers and wholesale payments, connecting all banks, non-banks, switches, and regional systems in Africa. The PAPS also compliments the COMESA Business Council's (CBC) cross border retail payment scheme, targeting Micro Small and Medium Enterprises (MSMEs) operating within the COMESA region. The extensive connection in the PAPS enhances the cross-border payment efficiency across Africa.

3.1.2 Retail payment system

The retail payments system serves the highest number of customers and the value of transactions and therefore has wider outreach in the economy. The retail payments system comprises of forty two Payment Service Providers (mobile money, Pesalink, cards, cheques, and electronic funds transfers (EFTs))

that facilitate end-to-end business and person transactions. As of December 2024, mobile money providers had a total active 30-day customer base of 36.9 million customers, an increase from 31.4 million in December 2023, implying that About 5.3 million new mobile money users registered in twelve months to December 2024 (**Figure 36**).

Figure 36: Monthly New Mobile Money Active Customers (millions)



Source: CBK, NPS data

The CBK increased the mobile money wallet size KSh 300,000 to 500,000, and the transaction limit from KSh 150,000 to KSh 250,000. This enabled customers, businesses and institutions including Government agencies to make and receive digital payments in larger amounts, thereby increasing the convenience of mobile money services in Kenya. It was also meant to

further deepen financial inclusion and facilitate businesses that have been constrained by the size of the mobile money wallet.

These changes however came with the requirements of PSPs to implement enhanced and appropriate risk mitigation measures to identify, mitigate and report risks, including

money laundering, financing of terrorism and proliferation finance; fraud including the risk of digital or online scams; operational risks; cybersecurity; including speedy resolution of customer complaints.

While the mobile money remains the most dominant retail payments system, there are other channels in this space that continue to play a key role settling transactions. These are use of cards (credit and debt), Automated Teller Machines (ATMs), Point of Sale (POS) devices, and Automated Clearing House (ACH) that facilitates Electronic Funds Transfers (EFTs). The number of cards and Point of Sale (POS) terminals increased slightly in 2024. However, the number of Automated Teller Machines (ATMs) increased to 2289 in December 2024 from 2,282 in December 2023 signalling opening of new branches. The ACH, which facilitates the exchange of cheques and electronic funds transfers (EFTs) between banks and their customers was upgraded to International Organization for Standardization (ISO) 20022 to enhance efficiency through Straight-Through-Processing (STP) as well as inclusion of more information in payment transactions. The ACH migrated to the new flexible and data rich ISO 20022 Standards in March 2023 in line with the National Payment Strategy 2022-2025 and global standards. The upgrade, spearheaded by Kenya Bankers Association (KBA) in collaboration with CBK, has improved efficiency, flexibility scalability and availed rich remittances data, which provides insights in payments. The CBK is also developing the fast payment system to

enhance interoperability, affordability and efficiency in the payments system.

3.3. Risks Assessment and Outlook

The increases in the number of PSP to 42 has significantly contributed to the growth and diversification of payment service delivery across the country. However, this also comes with consumer protection, financial stability and Money laundering, terrorism financing and proliferation financing risks. In addition, the prevalent use of payments data for credit scoring and designing other products provides incentive for misuse of personal data and data breaches. However, the CBK has authorised pricing proposals aimed at enhancing affordability and accessibility, thereby broadening consumer choices and improving overall service quality. Furthermore, to strengthen corporate governance standards within the sector, CBK conducted comprehensive vetting exercises and approved the appointments of senior officials across various PSPs, ensuring leadership integrity, accountability, and regulatory compliance. To further enhance compliance, CBK conducted sensitization and capacity building initiatives on emerging trends and cyber-security threats, Money Laundering, Terrorism Financing, and Proliferation Financing (ML/TF/PF) for the PSPs. The CBK has acted on cases of non-compliance with the aim of enhancing discipline in licensed PSPs and compliance to the law. Additionally, all PSPs have been mandated to file supervisory reports, with CBK linking its data warehouse with that of Payment Service

Providers systems to timely and accurate reporting for effective supervision. These initiatives have increased compliance by Payment Service Providers (PSPs), governance, financial health, cyber security, AML/CFT/CPF, legal and regulatory requirements.

Geo-political conflicts and geoeconomic fragmentations pose risks in terms of concerns for localization of processing of card transactions and payments. This is slowing down integration of the payments system and accelerating a switch to national system. Risks such as maintaining a robust business continuity framework, updating existing legal frameworks and guidelines to operationalize such initiatives may emerge. Enhanced

oversight of the risks identified among other existing ones is paramount. Additionally, the implementation of a risk-based framework will assist in the supervision of the licensed entities, where the approach, mitigation and enforcement measures will reflect the level of risk brought by each entity.

Cyber security risks. Cyber risks have increased due to the digitalisation of payments and transfer of money from person to person. The cyber threats increased from 805 million in 2022/23 to 3.5 billion in 2023/24 (**Table 13**) signalling a significant increase in cyber security risk. System misconfiguration had the highest increase in 2022/23 and 2023/24 while web application attacks were the lowest.

Table 13: Cyber Threats

Cyber At- tack Vector	20016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
Malware attacks	4,146,435	16,306,547	40,893,141	101,651,143	122,524,531	218,639,597	121,250,616	85,860,852	105,867,373
Web application attacks	2, 656,675	3,743,638	6,109,184	7,662,793	17,668,736	1,231,271	677,781	875,855	22,761,890
Botnet/DDOS	952327	3,756,334	4,852,022	1,475,537	16,236,587	120,064,763	5,584,166	115,618,883	113,512,716
System vulnerabilities/ misconfiguration	-	6,158	47,913	108,596	1,974,698	104,120,175	677,784,925	3,316,966,977	7,715,023,388
Total Cyber threats	7, 755, 498	23,815,972	51,903,286	110,898,069	158,404,552	444,055,806	805,297,488	3,519,322,567	7,957,165,367

Source: Communications Authority of Kenya

The motivation of cyber criminals targeting financial institutions is financial gains. Cyber fraud was prevalent in the banking sector in 2024, with reported cases rising from 153 in 2023 to 353 in 2024, and amount exposed increasing from KSh. 680.9 million to KSh. 1.9 billion. The actual loss following attacks rose from KSh. 412 million to KSh. 1.5 billion during the period, thus impacting negatively on the profitability of banks and ability to build more capital.

Table 14: Fraud cases and Exposure

Type of Fraud	No. of cases		Amount Exposed ('000s)		Amount lost ('000s)	
	2023	2024	2023	2024	2023	2024
Computer Fraud	11	12	145,961.2	203,413.0	74,840.3	203,394.9
Internet Scam	7	9	797.7	6,074.9	797.7	6,073.8
Mobile Banking Fraud	78	146	184,215.1	981,723.6	182,410.3	810,679.5
Online Banking Fraud	19	106	110,015.1	129,125.6	106,206.4	111,834.4
Card Fraud	21	24	16,148.1	439,440.0	15,597.1	263,288.5
Identity Theft	37	56	223,721.8	203,377.4	32,616.8	199,082.3
Total	173	353	680,859.0	1,963,154.3	412,468.6	1,594,353.4

Source: CBK

3.4. Artificial intelligence and machine learning

The financial sector is adopting artificial intelligence and machine learning in the provision of services and in their operations. The adoption of Artificial Intelligence (AI) has fundamentally reshaped the financial sector, and it possesses further potential to deepen product uptake and enhance efficiency. The term Artificial Intelligence is the science and engineering of creating intelligent machines, or simply, making computers act like humans to solve problems.

Machine Learning is a branch of AI that focuses on the using of data and algorithms to enable AI to imitate the way humans learn, gradually improving its accuracy. Generative AI (GenAI) (is subset of Deep Learning), a type

of artificial intelligence technology that can generate different types of content - such as text, imagery, audio, video - based on what has learnt from existing content

Post the financial crisis of 2008 and the more recent Covid-19 crisis, financial service providers have increasingly keen on advancing their quantitative capabilities to support timely and costeffective decision making as the world becomes more uncertain. The capital markets long standing focus on data analysis when designing products, analysing market behaviour and supporting forecasting has supported the increasing leveraging of AI and Generative AI techniques.

In the decision-making phase, AI predict market trends and asset prices by analysing past data.

AI technologies can also examine news, social media, and financial reports to understand how people feel about certain investments, which can help forecast how the market might react. These technologies can also assess the risks involved in various investments, considering factors like market changes or company performance. Additionally, AI can be used to optimize liquidity holding, investment portfolios, ensuring the right mix of assets is chosen to maximize returns while minimizing risks. When it comes to executing trades, AI and ML algorithms can automatically make trades at the best possible times, based on data patterns. This reduces the need for human intervention, saving time and lowering the chances of errors. AI can also predict how easily assets can be bought or sold in the market, helping traders avoid paying extra costs when making large trades

In the monitoring phase, AI is used to identify any unusual activity in the market in investment portfolios, reserves and sending alerts when developments are unusual including potential fraud, data breaches and cyber attacks. AI can also track how well investments are performing in real time, adjusting strategies when needed. Additionally, AI helps ensure that all trades and investments follow the necessary rules and regulations by checking for any issues that might arise. These tasks have a potential of realising significant efficiency gains, profits and optimal reserve holding, effective supervision and risk management, which confers greatest strategic and operational advantage to the financial sector. however, there are risks in the adoption of AI and ML. these are:

Ethical concerns: The integration of AI in decision making process generates ethical concerns related to privacy, bias and fairness, accountability, transparency and explainability. AI models have the potential to develop and incorporate certain social biases and potentially propose unwanted outcomes if the source data is inaccurate and wrong data analysis. Robo-advisory applications could potentially pose ethical harm by perpetuating biases if unchecked. Robo advisers can also use confidential financial information without being data compliant. Finally, there may be lack of transparency on how AI models make decisions given the opacity of the rules and parameters of the algorithm that is at the core of robo-advisory solutions. These concerns if not adequately addressed may hinder the uptake of robo-advisory solutions. Unfortunately, robo-advisory are widely used in the financial services providers.

Outsourcing risks: Investment firms rely on other third-party AI technology providers to automate the investment process and or provide advanced data analytics services face higher outage risks. Data privacy and security risks are amplified with the sharing of data for processing by third party AI technology providers. This makes financial services providers culpable under the data protection act, cyber crime and computer misuse act and sector specific regulations.

3.4.1. Algorithm development, testing and ongoing monitoring challenges.

The Financial Stability Board, IADI, WACCU and IOPS guidelines shows that there is no established framework for specifically developing AI and ML. Instead, many firms use the same development and testing frameworks that they use for traditional algorithms and standard system development management processes. Algorithms rely on quality data and most firms recognise the need for quality data inputs. Excessive immaterial, or irrelevant data is unwanted data that does not contribute to a relationship and may cause ML algorithms to miss the signal in the data and behave unexpectedly. Machine learning algorithms as they continue to learn may also tend to behave more unpredictably hence the need for continuous monitoring.

Data quality and bias: Poor quality data sets and insufficiency of the dataset will affect the performance and potential outcomes of the AI and ML models. Learned bias in the dataset can impact the decisions made by such algorithms and may result in discriminative decisions and provide undesirable outcomes to market participants. For example, asking questions phrased in a certain way or in a certain sequence may lead to a response that introduces implicit or explicit

bias from the respondents especially for robo-advisors. The Financial Stability Board, IADI, WACCU and IOPS advises that the principle of proportionality should guide regulators; consideration should be given to the activity that is being undertaken, the complexity of the activity, risk profiles, the degree of autonomy of the AI and ML applications, and the potential impact that the technology has on client outcomes and market integrity.

Anti-Money Laundering (AML)/Combating the Financing of Terrorism (CFT) risks

arises from potential use of digital products and channels to perpetrate the crime. Some of the cyberattacks circumvent AML/CFT requirements in such a way that makes it difficult for some PSPs and customers to detect and deter. PSPs therefore need to conduct enhanced monitoring and reporting as guided by law to mitigate the risks. Additionally, the requisite customer due diligence (CDD) processes must be applied and reviewed periodically. PSPs must remain vigilant in monitoring activities of customers, both retail and merchants to avoid promoting unlicensed activities such as online forex trading and processing of transactions related to virtual assets.

4. FINANCIAL STABILITY ASSESSMENT AND OUTLOOK

Risks to the global financial stability have been elevated by the increase in protection policies, geopolitical tensions and narrowing fiscal space in emerging and developing economies. Protectionist policies are rolling back gains in globalisations, which have facilitated movements in goods and services as well as capital flows across countries for decades. However, with trade wars ignited by USA imposing tariffs to over 184 countries, with China reciprocating with tariffs while other countries adopting non-tariff barriers or negotiating with USA. The protectionist measures, elevate for domestic prices consumers and producers, which not only reduces their incomes but also diversity of goods and services. Elevated prices slows down the pace of monetary policy easing, at a time when lower interest rates are required to ease financial conditions for the private and public sector to access affordable credit for investment.

The trade uncertainty and geopolitical tensions also elevate the risk profile for developing and emerging economies, which accentuate capital outflow and increase funding costs. The developing economies that export to USA and other advanced countries also face significant reduction in trade and export earnings. In addition, remittances and official foreign assistance from advanced and emerging economies to developing countries are likely to significantly reduce due to restriction to movement in labour, nationalistic sentiments and narrow fiscal space. Remittances and

official development assistance constitute a significant disposable income sustaining diverse economic activities.

The continued geopolitical tensions including Russia-Ukraine War, Israel-Hamas-Hezbollah war, and U.S-China trade tensions, have raised concerns about global economic and financial fragmentation. This has implications on the cross-border capital flows, international payment systems, asset prices, exchange rate and global trade. The risks to macro-financial stability are likely to emerge in terms of debt distress, increased funding costs, reduced earnings, constrained credit to the private sector and challenges in cross-border transactions in terms of settlement time and costs. Further monetary policy tightening or delayed monetary policy easing that keep interest rates higher for longer into first half of 2025 could impact negatively on global consumer demand. This could slow-down the pace of economic recovery in 2024 into 2025, thus heightening vulnerabilities of highly exposed countries in the EMDEs. The situation may be complicated by change of regimes in major countries that would make it difficult to reach consensus on the monetary and fiscal policy measures needed to put global economy to sustainable growth.

The financial sector is adopting technology deploying artificial intelligence and machine learning in the provision of services. In addition, financial services are more impersonal and provided through digital channels and integrated with other sector of the economy.

The increase in the interconnectedness within the financial sector and between the financial sector and rest of the economy increases the vulnerability points for cyber attacks and data breaches. The cyber threats have been exacerbated by geopolitical tensions and the monetary gains of the crime. In this regard, financial institutions, regulator and law enforcement agencies must develop strategies to not only combat national and regional conflicts and tensions, but also enforce laws and regulation to mitigate and discourage cyber crimes. More importantly, the prevalent use of digital channels and virtual assets provides a conducive environment and medium for money laundering, financing of terrorisms and proliferation financing activities. Despite the increase the ML/FT/PF incidences and vulnerabilities through digital channels using virtual assets, regulators especially in developing economies do not have adequate capacity to mitigate the ML/FT/PF risks. Therefore, regulators should enhance the cyber risks management frameworks and develop regulation and structure to mitigate risks.

The Sub-Saharan Africa region was resilient to the recent global banking sector turmoil, recording improved assets quality and stable capital base. It is however facing increased financial markets stress, accelerated capital outflows on flight to quality and safety strategies, elevated debt sustainability stress, and high cost of living. The region also faces high borrowing costs, worsening debt levels and challenges in accessing international

capital markets as yields on Eurobonds are persistently high. A policy mixing of reducing fiscal deficit to ensure debt sustainability and maintaining accommodative monetary policy to sustain economic recovery and financial stability. Policy makers in this region need to recognize all emerging risks and take appropriate intervention measures including the need to hold more capital and liquidity buffers against the risks.

In terms of hybrid risks, proactive policy actions to assess, quantify and institute measures to combat the potential risks of climate change must be accorded priority by SSA and EMDEs countries. This requires strong collaboration and effective coordination of both public and private sector players. Most vulnerable countries to climate change shock can consider mobilising resources for necessary funding for adaption and mitigation initiatives. Global cooperation and collaboration are also critical in dealing with climate change risks. Cybercrime and technology-related risks must be governed by commensurate regulation and supervision relative to the risk exposure to ensure quick remedial response and recovery to restore operations if an attack occurs. Information-sharing and incident reporting frameworks and helping emerging market economies build cybersecurity capacity are key to ensuring that all nodes of the network are resilient.

Countries faced with debt sustainability risks need to carefully implement fiscal consolidation measures without compromising provision of essential services to their citizens. Most of

these countries already face high cost of living crisis and therefore could seek concessional borrowing and support from international development partners to address the fiscal needs.

Domestically, Kenya's banking sector is expected to remain stable and resilient into first half of 2025, albeit elevated interest rates and credit risks as well as emerging operational risks. The sector has sufficient capital and liquidity buffers to withstand shocks. A few banks that are vulnerable to credit and interest rates may benefit from the expected easing of monetary policy tightening that would make market funding more accessible. The rising operational risks due to rising technological innovations and technology adoption can be mitigated by enhanced regulatory framework accompanied by a more robust supervisory and surveillance practices. In addition, institutions that are more vulnerable should have sufficient capital and liquidity buffers to absorb potential losses if these risks materialize. Investment in robust systems, enhanced internal control systems and well-capacitated teams would be critical in addressing the rising operational risks among institutions.

Insurance companies and pension funds are also expected to benefit from the recovery of markets, to register positive returns on their investments, growth in premiums and member contributions. Economic recovery and prudent management of Sacco societies are expected to contribute to further easing of credit risks and growth members deposits and numbers. Lastly, effective regulation of Dhow CSD and e-citizen through the amendments to the National Payments Act are expected to deepen the financial sector, thus enhancing financial system stability.

Overall, the global macrofinancial conditions outlook remains positive albeit legacy risks. This is also reflected in the domestic macrofinancial conditions for Kenya. Policy makers, regulators, authorities, and other players should remain vigilant to take appropriate measures and mitigate the risks for macrofinancial stability in 2024 and beyond. Collaboration and effective coordination among all stakeholders is key to achieving this goal.

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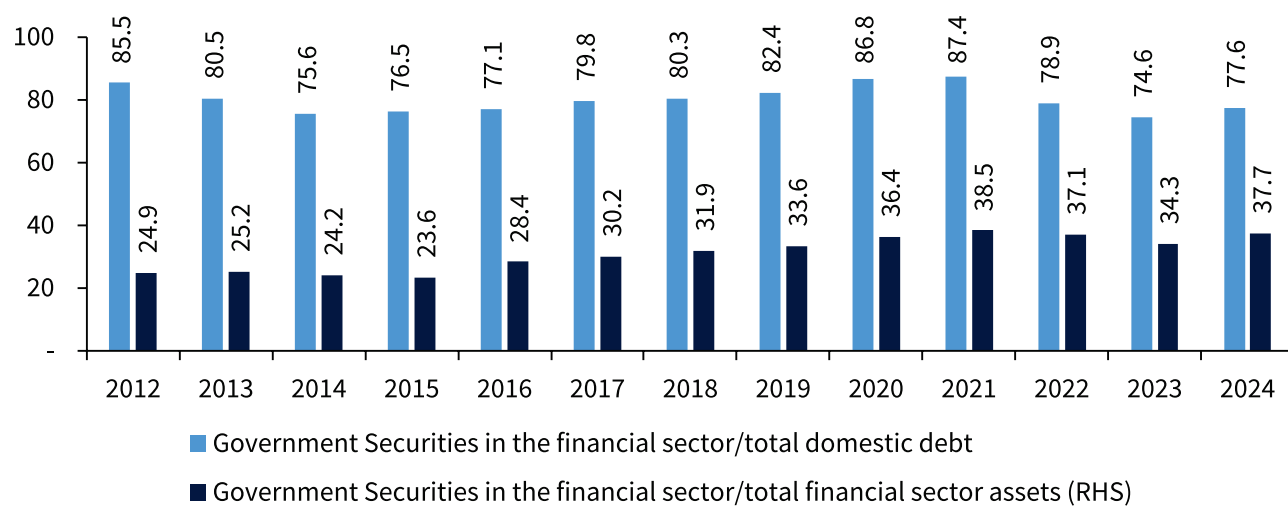
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Annex

Financial Sector Exposure to Public Debt







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