ICIFA
INSTITUTE OF CERTIFIED INVESTMENT AND FINANCIAL ANALYSTS

# INVESTMENT REVIEW

A JOURNAL OF THE INSTITUTE OF CERTIFIED INVESTMENT AND FINANCIAL ANALYSTS

Issue 04: March 2020

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# who WE are

ICIFA is the professional Investment and Financial Analysts' body mandated by law to regulate the Investment and Financial Analysis profession in Kenya, being the only body authorized by law to register and grant practising certificates to ertified Investment and Financial Analysts (CIFAs) in Kenya both in private and public practice under the Investment and Financial Analysts Act (No.13 of 2015).

We are dedicated to providing region-wide network and promoting the role of the profession in the fields of investment and financial analysis, ension funds, asset management, corporate finance, investment and finance training, fund management, financial advisory, wealth management, real estate investment, insurance investment advisory, capital markets operations, and investment banking among others. ICIFA provides highly skilled, competent, competitive professional expertise in all sectors in the investment and finance industry.

We are globally affiliated to Association of Certified International Investment Analyst (ACIIA) based in Switzerland, the African Securities Exchange Association (ASEA) and the Association of Professional Societies in East Africa (APSEA). The examination body for Certified Investment and Financial Analysts Examination is KASNEB.

ICIFA
INSTITUTE OF CERTIFIED INVESTMENT AND FINANCIAL ANALYSTS

**Legal Mandate**

The Investment and Financial Analysts Act (No.13 of 2015) provides for the establishment, powers and function of the Institute of Certified Investment and Financial Analysts, for the provision of the examination and registration of certified investment and financial analysts, and for connected purposes.

**Vision Statement**

To be a global leader in standards of professional ethics, training and research for investment and financial professionals.

**Mission Statement**

To be a global leader in standards of professional ethics, training and research for investment and financial professionals.

**Core Values**

To provide competent investment and financial professionals by upholding integrity, promoting research and driving innovation in financial markets.


# Functions of the Institute under the Investment and Financial Analysts Act, 2015

a) To promote standards of professional competence and ethical practice amongst members of the Institute.

b) To promote research into the subjects of the securities and investments and related matters, and the publication of books, periodicals, journals and articles in connection therewith.

c) To promote the International recognition of the Institute.

d) To advise the regulator for the time being responsible for capital markets in respect of licensing investment and financial analysts.

e) To advise the Examinations Board on matters relating to examinations standards and policies.

f) To design and administer an initial ethics and integrity test for the purpose of determining the professional suitability of all its members and to subsequently design and undertake such continuous development programs for its members.

g) To carry out any other functions prescribed for it under any of the other provisions of the Act or any other written law.

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# BENEFITS OF MEMBERSHIP IN ICIFA

**Recognition**

When you become a member of ICIFA, you become truly recognized as a qualified and certified investment and financial analysis professional. International recognition has also been made easier through the new partnership between ICIFA and CISI and the partnership between ICIFA and ACIIA.

**Continuous Professional Development**

Enjoy benefits of ICIFA trainings, conferences, workshops, forums, seminars at discounted fees once you become a member.

This will greatly enrich your CV, make you current and relevant in competences and skills in the investment and financial analysis industry. Members also have exclusive access to relevant and current publications at discounted fees.

**Leadership Development**

Opportunity to volunteer towards helping organize events and conferences, towards membership development and so on.

Opportunity to compete for roles on the main ICIFA committees or the Council. This gives you a unique chance to develop team work and leadership skills which are vital for professional development

**Networking**

Opportunity to network with numerous people in the investment and financial analysis profession including leaders and influential people in the industry. This is one of the easiest ways to quickly and greatly expand the reach of your networking.

**Opportunities**

ICIFA broadcasts many relevant opportunities to their members including opportunities for recruitment, consultancies, professional development, research, training etc.

***Why not enjoy these benefits as a bonus when you become a member of ICIFA?***

# Membership Categories

## Associate Membership

Persons who have passed their Certified Investment and Financial Analysts (CIFA) professional qualification and have complied with section 16 (3) of the Act but have less than three years of relevant work experience shall be eligible for registration as Associate Members of ICIFA.

## How to Register as an Associate Member

· ICIFAMembership application form

· ICIFA Fit and Proper form (to be signed by a commissioner of oaths) and attach certified copies of:

1. Up to date CV;
2. National ID or Passport;
3. Two colored passport photos;
4. Recommendation letters from previous and current employers
5. A copy of your academic and professional certificates;
6. Any other important document.

## Full Membership

Persons who hold the Certified Investment and Financial Analysts (CIFA) professional qualification and have complied with section 16 (3) of the Act and have at least three years of relevant work experience shall be eligible for registration as Full Members.

## How to Register as a Full Member

Kindly fill the following forms:

- ICIFA Membership application form
- ICIFA grant of Practicing Certificate form (If applying for practising certificate)
- ICIFA Fit and Proper form (to be signed by a commissioner of oaths) and attach certified copies of:

1. Up to date CV;
2. National ID/ Passport;
3. Two colored passport photos;
4. Recommendation letters from previous and current employers;
5. A copy of your academic and professional certificates (CIFA, CFA or CIIA final examinations);
6. Any other important document.

# A word from the CEO

FA Diana Muriuki

*Chief Executive Officer, ICIFA*

Dear Reader,

It is my pleasure to present to you our 4th issue of the Investment Review Journal at a time when the world is grappling with the effects of the Covid-19 pandemic. In the midst of the ongoing crisis, the Institute conducted a survey from its membership to seek their views on government intervention measures that could lead to Kenya's economic recovery plan after the COVID – 19 crisis. The survey was deemed necessary following the World Health Organization (WHO) categorizing COVID-19 as a pandemic, and the confirmation of the first case in Kenya by the Ministry of Health on 13th of March, 2020.

The pandemic has undoubtedly changed the course of the economy with some observers expecting a 'new normal' of sustained low growth. As a professional body we have taken keen interest in the proposals made by policymakers and business associations.

In this issue we also focus on innovation in the financial services sector and we have included articles that look at the interesting development in the capital and financial markets in Kenya. The emerging issues in some of these articles demonstrate increasing prospects for Investment and Finance professionals as they focus on service delivery.

Given the current times, the Institute is also in the process of implementing online training solutions for its membership and other targeted market employees working within the capital markets. This will ensure that the professionals are able to undertake their Continuous Development with flexibility and convenience.

I wish to thank my team, the Education & Research Committee for their valuable input and support during the preparation of this issue and also the authors who submitted their articles for publication.

We urge that you observe the Ministry of Health's directives to contain the spread of the virus. We are indeed in unprecedented times but it is also a time to display hope, kindness, generosity and courage.
Stay Safe!

Yours Sincerely;

**FA Diana Muriuki-Maina**
**Chief Executive Officer**

# ICIFA PARTICIPATES AT KASNEB OPEN DAY, KISUMU


The Institute participated at the Kasneb Open Day held on the 7th – 8th of February 2020 at the Kisumu National Polytechnic.

The purpose of the Open Day was to facilitate interaction between Kasneb and its stakeholders who included existing and potential students, training institutions and employers, in order to sensitize its professional brand.

The Institute used the platform to showcase its services and opportunities to existing and potential CIFA students as well as offer them career guidance and mentorship.

# 3RD GRADUATES FORUM


The **3rd CIFA Graduates Breakfast Forum** was held on **Friday, 6th March 2020** at Kasneb Tower II, Upperhill, Nairobi from 7.00 am to 10.00 am.

The purpose of the forum will be to provide career mentorship and advice for various roles in the investment and finance industry as well as networking with key stakeholders and experts in the financial services sector. The forum will also address the benefits of working as a registered Investment & Finance professional.
The Guest speakers included; FA Nganga Njiinu, FA Einstien Kihanda, FA Leah Nyambura, FA Lazarus Kimanga, FA Vincent Kiio and FA Dr. George Wakah.

# NOTICE ON IMPLEMENTATION OF ONLINE CPD

With regard to the postponement of the Continuous Professional Development (CPD) events, the Council of the institute has resolved to fast track the implementation of online CPD courses via the online member portals.

Further communication will be sent once the online CPD courses will be fully operational. In the meantime, members who have not yet activated their member portal are requested to do so by following this link https://icifa.co.ke/members/member_create_account/

Members are advised to be up to date with year 2020 subscriptions taking into account the deadline lapsed on 28 February 2020.

We request that subscription payments made via our bank account be supported by proof of payment sent to our official email addresses as indicated. Please also take note that gazette notices of members and firms in good standing will be published in the Kenya Gazette twice a year as at 31 March and as at 30 September.

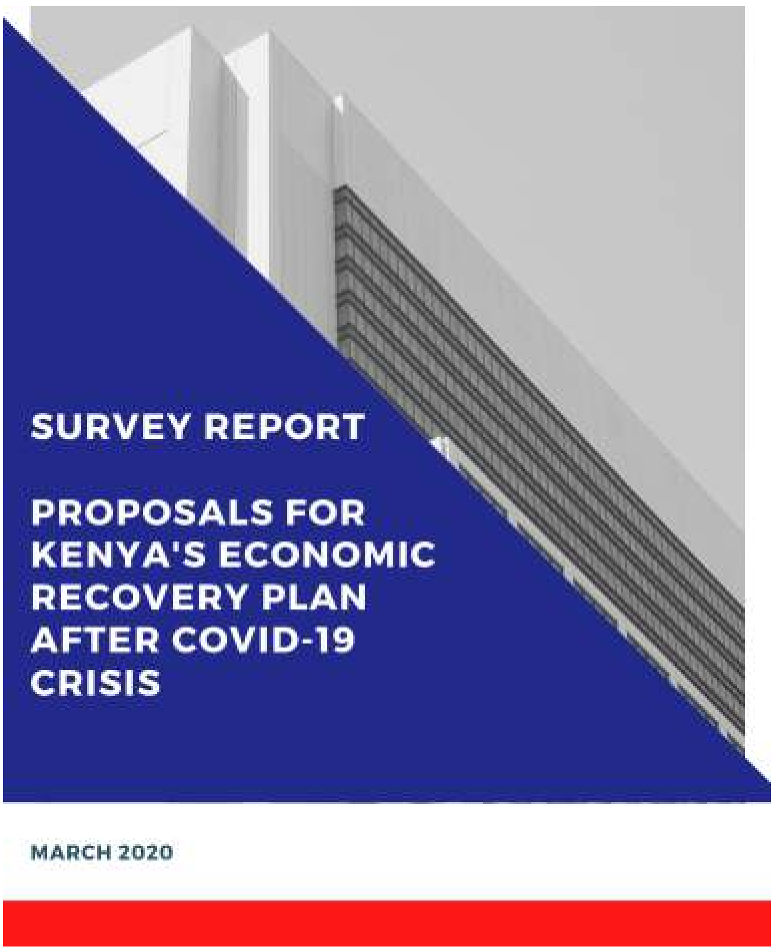
The Institute shall continue to monitor all developments related to COVID-19 in Kenya and keep members informed of any important information.

# ICIFA PROPOSALS FOR KENYA'S ECONOMIC RECOVERY PLAN AFTER COVID-19 CRISIS

Members of the Institute have put together a raft of measures to cushion Kenya's economy from the negative impacts of the COVID- 19 pandemic.

According to a survey conducted by the Institute of Certified Investment and Financial Analysts (ICIFA), the Government of Kenya needs to urgently seek to re-finance its debt cheaply in the international markets with interest rates at 0%.

In the short term, the survey recommends fiscal consolidation at the National and County levels of government to reduce deficits and accumulation of debt. "In so doing, the Government could consider to engage fiscal consolidation to mitigate the risks of the pandemic failure to which could cause a rise in the cost of borrowing for the Government and undermine macroeconomic stability with widespread economic costs", the survey report says in part.




Other short term measures include restructuring of the current Government debt, further reduction of the Central Bank Rate, price controls to prevent inflation due to reduced supply, good governance and proper use of resources.

Further, ICIFA opines that the Government must take prompt actions and short term measures on addressing emerging global issues by reducing poverty, investing in food security and growing the economy and reduction of Government spending on non-priority development projects and allocate the funds to more urgent sectors such as healthcare in increasing diagnostic capacity and setting up more ICU beds in the counties. The proposals include embarking on public education of the citizens on crisis management to enable the country deal with situations of pandemics, enforce strong austerity measures through the National Treasury to ensure the country's budget is balanced and surplus created.

The respondents of the survey opine that the Government should support public campaigns on personal budgeting to create a strong saving culture in Kenya. In summary, the survey identified the following priorities:

a) Invest in local manufacturing to avoid over reliance on imports at a time of crisis
b) Institute a robust healthcare system that is responsive to the citizenry and in constant communication with global trends
c) Invest in sufficient skilled medical personnel who are trained on pandemic response
d) Invest in research and innovation in the health sector
e) Effective monitoring of borders and entry points
f) Identify a committee of experts drawn from professional bodies from relevant sectors to provide recommendations on a quarterly basis on potential impacts on government directives.

69% of the respondents believed there is a high likelihood of a global recession with 54% of the respondents estimating a recovery period of less than or equal to 1 year. The respondents of the survey were 93 ICIFA members with 55% of the respondents drawn from the private sectors, 31% from the public sectors and 14% respondents from the education, commercial and non-profit sectors

# POSTPONEMENT OF ICIFA EVENTS AND FORUMS (MARCH AND APRIL 2020)

Nairobi, 13th March 2020, Taking into account the rapid increase of the COVID-19 cases worldwide, the confirmed case of the Virus in Kenya by the Ministry of Health on 13th March 2020, and the CS, Ministry of Health statement as at 13th March 2020 on suspending all public gatherings and events, the Institute hereby gives notice that the following events and forums are now postponed until further notice:

- 19 - 20 March 2020 - ICIFA 3rd Annual Conference 2020;
- Other CPD forums and events to be held in the months of March and April 2020.

The Council of the Institute shall continue to monitor all developments related to the Virus in Kenya and carry out consultation on additional postponements required in the interest of public health and safety.

Rescheduling of the postponement of all events and forums to be held in the months of March and April 2020, will be announced in our subsequent press releases to enable our members and affiliates make appropriate arrangements.

We take this opportunity to thank all our conference Sponsors, Chief Guest, Guest Speakers, Delegates and supporters for their support and understanding and we look forward to advising new dates for the 3rd Annual conference.

FA Dr. Jonah Aiyabei
CHAIRMAN, ICIFA

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# FINANCIAL DEVELOPMENT: THE CASE FOR FINANCIAL INCLUSION

FA Vincent Langat

Financial inclusion (FI) continues to receive global recognition as a key driver in enhancing economic development and in achieving sustainable and inclusive growth. Financial inclusion simply defined as the access to appropriate, convenient, usable, valuable, and affordable financial services and products has the objective of bringing all segment of the population to formal financial institutions to improve their livelihood, elevate poverty and reduce social inequality. Components of financial inclusion are the products (payments, savings, credit and insurance); features of these products (quality, availability, convenience and affordability); and their channels (access points, financial infrastructure and institutions)

Studies indicate that financial development avails ex ante information that is important in advising areas of investments and utilization of scarce resources. It also facilitates trading, diversification and portfolio management of financial assets. Of great value is its role in mobilizing funds for savings, investments, insurance and exchange of goods and services. Financial development therefore ensures that the society benefits from economic growth, reduction of poverty, and enhanced economic stability. When a person is locked out of the formal financial system then they are not able to gain from all these benefits. The goal of financial inclusion is therefore to on board everyone into the formal financial system so that they can at least step out of poverty, be financially empowered, protect themselves against hardship, and invest to secure their future.

> **Unfortunately, barriers to financial inclusion still exist cutting across different countries and segments of the society**

The globe has witnessed tremendous growth in the level of financial inclusion. The Global Findex database (2017) points out that approximately 3.8 billion people representing 69 percent of global adults' population have access to formal financial services mostly banks and mobile money accounts. This has been accelerated by reforms in the financial sector and innovations on mobile phones, internet and the digital technology. The most common use of financial products by households across the globe according to the Findex database is to receive salaries and other income, make payments for goods, services and utility bills, send money to friends and relatives, save and borrow funds, finance and grow business, and to mitigate shocks and other vulnerabilities. Eventually, all these are aimed at improving their welfare and social well being.

Unfortunately, barriers to financial inclusion still exist cutting across different countries and segments of the society. According to the World Bank, almost 1.7Bn people are still financially excluded with a majority of them in the low income countries. Some of the factors that causing this include the high cost and requirement for having a financial institution account, geographical barriers to access a financial touch point, and inappropriate products which all constitutes the supply-side factors. Demand-side barriers include poverty, financial illiteracy, religious beliefs, and other social impediments such as cultural discriminative beliefs against women.

Kenya has made significant strides towards achieving financial inclusion with over 80% of the adult population having access to a formal financial service according to the latest 2019 Fin Access household survey. Account ownership for adults as a percentage of the total population has increased from 2014 to 2018 from 74.7% to 81.6% respectively. This same period witnessed an increase from 55.2% to 55.7% of the adult population with financial institutions accounts while those with mobile money accounts increased from 58.4% to 72.9%.

From research, Kenyans and many people in low income countries have myriad reasons why they use financial services.

The main reason being to develop their lives and those of their dependents in meeting needs in areas such as education, health, food, and entertainment and secondly to cultivatesocial relationships where they can extend a hand to assist others. Financial service providers have come to the realization of these social behaviors and developed innovative tools to address them and overcome existing barriers of financial inclusion. This has worked to transform thefinancial ecosystem in the country resulting to policy reforms such as agency banking, national payments regulations and new initiatives to improve quality of financial products and services.

Several innovative solutions that has been witnesses in Kenya over the years include: Sharia compliant banking (2005), Microfinance Act (2006), Digital Financial Services (M-Pesa2007), Credit Information Sharing (CIS) Mechanism (2008), Agency banking (2010), M-Akiba (2017), Stawi (2019), and Treasury Mobile Direct (2020).

These advancements have had a positive impact on delivery, efficiency, stability and outreach of financial services. New Fintech productson credit, payment, savings, insurance and pension have also emerged. However, even with these positive effects, many consumers have fallen victims of cyber losses. People have been subjected to risks including loss of their consumer right, breach of their privacy, fraud and cyber-attacks, and unreliability of the technology sometimes due to system downtime. Another major issue is money laundering that challenges financial integrity.

Government, regulators, financial institutions, infrastructure providers, technology providers and other players including NGOs, education and supranational institutionsare key stakeholders who play a big role in promoting financial inclusion. This year's theme for the 3rd Annual Conference of ICIFA on 'Fostering innovation and Creativity in the investment and Finance Industry' comes at a good time whenthere is a need for all stakeholders to come together, engage in concerted efforts, cooperation and partnerships to create a conducive environment for fostering financial inclusion. Indeed, no given single entity has the ability to drive financial inclusion. Efforts are needed to offer financial support, the necessary infrastructure and technical assistance for innovations, incubation, and ventures that are working to enhance financial inclusion, and also promote financial literacy so as to empower consumers and abide by key principles of financial consumer protection. Regulations, supervisions and key reforms are also needed warrant safety and soundness of financial products that work to improve the welfare of users by meeting their financial needs and at the same time safeguard financial stability and financial integrity.

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*FA Vincent Langat is a full member of the Institute of Certified Investment and Financial Analysts*

# KENYA IS RIPE FOR PRIVATE EQUITY ETF LISTINGS

FA Peter Onyango
*Head Risk Analysis & Stress Testing – Derivatives*
*Capital Markets Authority*

In the spirit of fostering innovation and creativity in the Financial Markets industry, the players of the capital markets need to move out of'brick and mortar' business plans and consider disruptive inventions similar to how Safaricom'sMpesa disrupted the payment industry. One product that is untapped isthe Exchange Traded Fund framework published by the Capital Markets Authority in 2015[1].

Exchange Traded funds or ETFs is a simple way to obtain exposure to the capital markets.An ETF is a type of fund that owns assets like stocks, commodities, or futures, but has its ownership divided into shares (or units) that trade on stock exchanges. In other words, investors can buy and sell ETFs whenever they want during trading hours at low trading costs.

An ETF can have a wide range of assets that it can be created from. For example,Kenya can issue an ETF that tracks the Brazilian stock market or Japanese stock market, or tracks commodities like maize, crude oil or gold.ETFs and unit trusts have similar characteristics with the exception that unit trusts are non-exchange tradeable. Notably, an ETF is not a derivative. An investor who purchases units of an ETF is purchasing a security that is backed by the actual assets specified by the fund's charter, not by contracts based on those assets. This distinction ensures that ETFs neither act like nor are classified as derivatives.

ETFs generally have lower costs than other investment products, because most of them are not actively managed. There is flexibility in buying and selling of assets. ETFs can be bought and sold at current market prices at any time of the trading day, unlike mutual funds or unit trusts that can be traded at the end of the trading day. ETFs are tax efficient. Typically generate relatively low capital gains, as they have low turnover of portfolio securities. ETF provide an economical way to rebalance, i.e. portfolio diversification across the index[2].

The first successfully listed ETF was theS&P500 (named “Spiders” becauseof its stock ticker symbol or SPDR)in January 1993. The SPRD tracks the S&P 500 index, an index made up of the largest of the U.S. stocks. It is still today the largest ETF with assets of over $319 billion. Following the introduction of the SPDR, thousands of ETFs are trading globally and by the end of 2018 the industry consisted of 12,516 listed ETF funds with a combined market capitalization of close to $25 trillion[3].

| | Symbol | Name | AUM in Billions | Avg Volume in Millions |
|---|---|---|---|---|
| 1. | SPY | SPDR S&P 500 ETF | $319 | 56 |
| 2. | IVV | iShares Core S&P 500 ETF | $207 | 3 |
| 3. | VTI | Vanguard Total Stock Market ETF | $144 | 2 |
| 4. | VOO | Vanguard S&P 500 ETF | $135 | 2 |
| 5. | QQQ | Invesco QQQ | $92 | 2 |
| 6. | VEA | Vanguard FTSE Developed Markets ETF | $80 | 7 |
| 7. | IEFA | iShares Core MSCI EAFE ETF | $74 | 8 |
| 8. | AGG | iShares Core U.S. Aggregate Bond ETF | $70 | 4 |
| 9. | VWO | Vanguard FTSE Emerging Markets ETF | $69 | 11 |
| 10. | EFA | iShares MSCI EAFE ETF | $65 | 21 |

Source: ETFdb.com. https://etfdb.com/compare/market-cap/ Retrieved date Jan 19, 2020

[1] Exchange Traded Fund Guidance Notes (Sep 2015). *The Capital Markets Authority of Kenya*. Retried from www. cma.or.ke
[2] Petrova, E. (2016). A brief overview of the types of ETFs. Available at SSRN 2728144.
[3] WFE and IOMA (April 2019). *WFE IOMA 2018 Derivatives Report*. World Federation of Exchanges and International Options Market Association
[4] The term “Assets Under Management – AUM” shows the market value of assets investment company managed on the behalf of investors. Assets under management (AUM) are regarded as measure of success against competition and comprise growth/drop is due to the increase/ loss of capital and new inflow/outflow of money.
[5] The term “Average Volume” shows the average number of traded shares.

In Kenya, the only listed ETF is the Barclays New Gold ETF that is currently trading at the Nairobi Securities Exchange.

Now, how can we link ETF's with Private Equity?

South Africa, Morocco and Kenya are ranked as Africa's top hotspots for private equity deals. Private equity is basically investing in companies that aren't listed on any stock exchange. Normally, sizeable private equity funds and high net-worth individuals buy stakes in private companies or own them outright. It's a relatively opaque market, has no space for retail investors and stakeholder funds is usually tied up for several years. On the positive side, it's a sector thatdelivers good returns as well as weathers recessions fairly well.

Kenya is East Africa's most popular investment destination, according to a recent report published by the PWC and the East Africa Private Equity and Venture Capital Association (EAVCA). Of the $6.4 trillion private equity funds raised globally between 2007 and 2018, $33.1 billion was earmarked for Africa and $3.3 billion for East Africa. Of the total 84 deals reported by the private equity sector in East Africa, 73% is domiciled in Kenya. Sectors such as crowdfunding, healthcare, agricultural commodities, disruptive technology like blockchain, alternative energy, big data and betting have benefited from capital inflows through PE. With a median IRR of 20%, private equity returns aresignificantly higher than the returns of local government securities.

Given the current bear run in the country's capital market, how can the NairobiSecurities Exchange tap into growth of the private equity sector?

Well, Private Equity ETFs (PE-ETFs) provide investors with an opportunity to gain exposure to Private Equity companies without having to buy stakes in the PE itself.

The participating PE's as a reward, will obtain massive visibility without having to conform to the requirements of direct listing. Noting existing global PE-ETFs track indices constructed using listed PE funds. For Kenya, a solution for index computation could be to pursue the 'Appraised value-based Indices' (AVI) methodology researched and published by Asset Metrix. The AVI is an index computed based on cumulative cash flows and net asset values (NAV) of the underlying PE. To ensure transparency and accountability, a reputable financial data vendor with the blessings of the East Africa Private Equity and Venture Capital Association, can be contracted to be collating data from subscribed PE's and regularly computing the index.

An ETF listed on an exchange that tracks unlisted PE's seems far-fetched but remember with Mpesa, Safaricom made lemonade out of lemons.

Indeed, the country has a facilitative capital markets regulator. The Capital Markets Authority has been feted as the most innovative capital markets regulator in Africa four years in row (2015-2018). A notable accomplishment for the CMA is its willingness to receive applications for disruptive and innovative solutions through its Regulatory Sandbox framework. This framework allows successful applicants to live test innovative solutions with the capacity to deepen and enhance the efficiency of the capital market.

ETF's are extremely popular all over the world and there is no reason why they shouldn't be used as a framework to onboard exotic securities onto an exchange. To compliment the Gold ETF, it is time for additional innovative ETF's to be listed on the NSE.

*FA Peter Onyango*
*Head Risk Analysis & Stress Testing – Derivatives*
*Capital Markets Authority*

[6] PWC and EAVCA (June 2019). *Private Equity Sector Survey of East Africa for the period 2017 to 2018*. Retrieved from https://assets.kpmg/content/dam/kpmg/ke/pdf/deal/PE%20Survey%20Booklet%202019.pdf

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# Demystifying Private Equity & Venture Capital structures and its additional investment risks

FA Eric Munywoki

In Kenya, Private Equity (PE) & Venture Capital (VC) Investments remain a new concept that is yet to be exploited by Retirement Benefits Industry. Going by the RBA industry report (Dec-18), Private Equity (PE) & Venture Capital (VC) allocations accounted for less than 1% (Vs. 10% allowable maximum) of the total assets under management in spite of prevalent investments by foreign PE firms. Generally, Alternative investments have proven to be intensely controversial choices for pension funds, as disputes in geographies as diverse as California, Germany, and Japan have illustrated.

According to OECD 2018 pension funds survey, historical asset allocation for a group of 29 Large Pension Funds shows that allocations to alternatives (including infrastructure) increased to 13.8% of total assets in 2018 (vs. 12.7% in 2010) which is lower compared to Kenya's 19.8% (property as an alternative asset class accounts for over 98%) in 2018 (vs. 17.2% in 2013). Narrowing to PE & VC investments, funds such as Canada's OTPP, which invested 42.6% of total assets in alternative/other investments, had 14.1% (vs. 0.1% in Kenya) allocation to PE.

**Overall Industry Investment Portfolio (Kshs in Billions)**

| | Assets Category | Maximum allowable % | Dec-16 | | Jun-17 | | Dec-17 | | Jun-18 | | Dec-18 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Kshs | % | Kshs | % | Kshs. | % | Kshs | % | Kshs | % |
| 1 | Government Securities | 90% | 349.15 | 38.26 | 353.47 | 36.7 | 394.19 | 36.49 | 423.7 | 36.32 | 459.68 | 39.41 |
| 2 | Quoted Equities | 70% | 159.07 | 17.43 | 180.35 | 18.73 | 210.17 | 19.46 | 241.46 | 20.7 | 201.51 | 17.27 |
| 3 | Immovable Property | 30% | 178.42 | 19.55 | 204.6 | 21.25 | 226.72 | 20.99 | 229.32 | 19.66 | 229.91 | 19.71 |
| 4 | Guaranteed Funds | 100% | 129.58 | 14.2 | 103.67 | 10.76 | 142.97 | 13.24 | 159.63 | 13.68 | 167.45 | 14.36 |
| 5 | Listed Corporate Bonds | 20% | 46.95 | 5.14 | 46.83 | 4.86 | 41.99 | 3.89 | 41.51 | 3.56 | 40.28 | 3.45 |
| 6 | Fixed Deposits | 30% | 24.57 | 2.69 | 45.49 | 4.72 | 32.88 | 3.04 | 31.62 | 2.71 | 36.39 | 3.12 |
| 7 | Offshore | 15% | 6.96 | 0.76 | 9.68 | 1 | 12.77 | 1.18 | 15.03 | 1.29 | 13.13 | 1.13 |
| 8 | Cash | 5% | 12.93 | 1.42 | 13.91 | 1.44 | 12.95 | 1.21 | 8.99 | 1.63 | 12.72 | 1.09 |
| 9 | Unquoted Equities | 5% | 3.95 | 0.43 | 3.91 | 0.41 | 4.06 | 0.37 | 3.78 | 0.32 | 3.79 | 0.33 |
| 10 | Private Equity & Venture Capital | 10% | 0.22 | 0.02 | 0.25 | 0.03 | 0.32 | 20.03 | 0.42 | 0.04 | 0.86 | 0.07 |
| 11 | REITS | 30% | 0.84 | 0.09 | 0.888 | 0.09 | 1.03 | 0.1 | 1.01 | 0.09 | 0.71 | |
| 12 | Commercial paper, non- listed bonds by private companies | 10% | | | 0.002 | 0 | 0.062 | 0.01 | 0.22 | 0.02 | 0.06 | 0 |
| 13 | Derivative stocks | 5% | | | | | | | | | | |
| 14 | Any other assets | 10% | | | | | | | | | | |
| | TOTAL | | 912.66 | 100 | 963.05 | 100 | 1,080.11 | 100 | 1,166.70 | 100 | 1,166.49 | 100 |

*Source: Retirement benefits Industry Report for December 2018*

Unlike in the past where the authorities took stealth approach to new investment concepts/dynamics, there are rapid evolving investment paradigms across the world today that encourage innovation within the investment industry.

In this article, I will focus onarticulating issues around low commitments by local pension managers as well as give views on ways of mitigating these challengesborrowing best practices globally. As such, I will cover;

I. Why the truncated PE&VC investing by local pension managers?
ii. What needs to be done as a feasible solution?
iii. The options for creating PE exposure
iv. Structure of PE&VC funds
v. The PE investment process
vi. Outlook and conclusion

Why the truncated PE& VC investingby local pension managers?

Although PE & VC investing is usually perceived to have high risk, illiquid, long investment horizon and inconsistent valuations, it not only gives above average returns[3] but also creates solid companies which end up getting listed in securities markets.

[1]Allowable maximum is 90% , or 100% in the case of scheme receiving statutory contributions
[2]Unlisted shares and equity instruments of companies incorporated in Kenya and collective investment schemes incorporated in Kenya and approved by the Capital Markets Authority reflecting this category.
[3]According to the latest data from Preqin, PE has averaged 14.4% annually over the past 5 years – a far superior return compared to most asset classes

In Kenya, there seems to be some factors antagonizing this kind of investments by pension funds. In my view, hindrance to alternative assets such as PE gaining traction in Kenya is how the assets are structured (i.e. allowable maximum allocation, fund administration, capacity etc. and the fear of unknown (excess dry powder).

What needs to be done as a feasible solution?

This paradox of truncated appetite for PE & VC investments by local pension managers can be addressed by;

i. Reviewing the maximum percentage of aggregate market value of total assets of scheme or pooled fund and
ii. Democratizing Limited Partner (LP) - General Partner (GP) relationships.
iii. Building institutional capacity
iv. Holding sizeable portion of funds as dry powder

Globally, these concepts are widely used not only by large public pension funds but also by approved endowment funds[4].

Authorities need to revise PE maximum allowable allocation upwards to allow for sizeable commitments by local pension funds –Limited partners (LPs)[5]. Depending on the size/available commitments, many LPs end up underinvesting on lucrative investment opportunities due to low maximum allowable limit (LP can diversify in different GPs which in turn may also diversify in different funds). Regular reviews on investments asset classes to align them with market developments enhance portfolio diversification, improve risk management and boost fund performance. Last year, 14 large Kenyan pension funds came together and formed the Kenya Pension Fund Investment Consortium (KEPFIC)[6] as a means of mobilizing domestic capital for long-term investments. This is a step in the right direction.

Moreover, after the LP has made the investment, it has very little to say how the fund manager –The PE firm - (GP)[7] invests the capital, as long as the basic covenants[8] of the fund agreement are followed hence the need to review the current structure of LP-GP relationships. Today, LP-GP relationships have changed[9] and a growing number of LPs worldwide are seeking greater involvement in managing their money than before by either investing directly or co-investing[10] alongside the GP in companies they like. In spite of this increasing LPs risks, it gives them greater flexibility to pick companies to invest in and have the potential to control their returns.

This also gives them an option to invest further in the best-performing companies in the GP's portfolio. In both situations, because investors pay lower or no fees for the additional investment, they get a higher profit on these 'blended' investments if the company is successful.On the flipside, it's good to note that majority of GPs scowl when some of their backers (LPs) compete in direct investing[11]. In addition, a direct route is also likely to be pegged with corruption as evidenced in mostof Pensions investments in real estate hence need for proper corporate governance driven by ethics to guide the investment processes as LPs and GPs would argue.

Notwithstanding, most Pensions have challenges with internal capacity to source/invest/monitor/create value in this asset class - hence doing it via a PE structure is preferred[12]. These institutions ought to deal with internal capacity challenges first before taking the bold moves to invest directly.In fact, Investment professionals usually describe PE as difficult asset class to invest in and the success in PE investment is heavy dependent on the skill of individual investor/manager[13]. Managers review multiple documents provided by the investee companies and perform dozen of analysis and observe entry multiples before making any investment commitment. However, of concern is that the manager offer internal rate of return estimates bases on how their assets are performing, but asset performance can be subjective and hard to measure when the investments are not sold in a public market.

Although private equity funds hold a sizeable portion of their funds as dry powder in anticipation of better deals, sometimes they may hold excess dry powder when there no attractive deals to invest in. Maintaining high levels of dry powder leads to high valuation multiples and increased deal-making. A fund can deploy the ready capital when it finds a high-quality target with a huge potential for growth. To avoid holding excess dry powder regardless of the structure, the LP or GP should develop a strong deal pipeline before making the commitments.

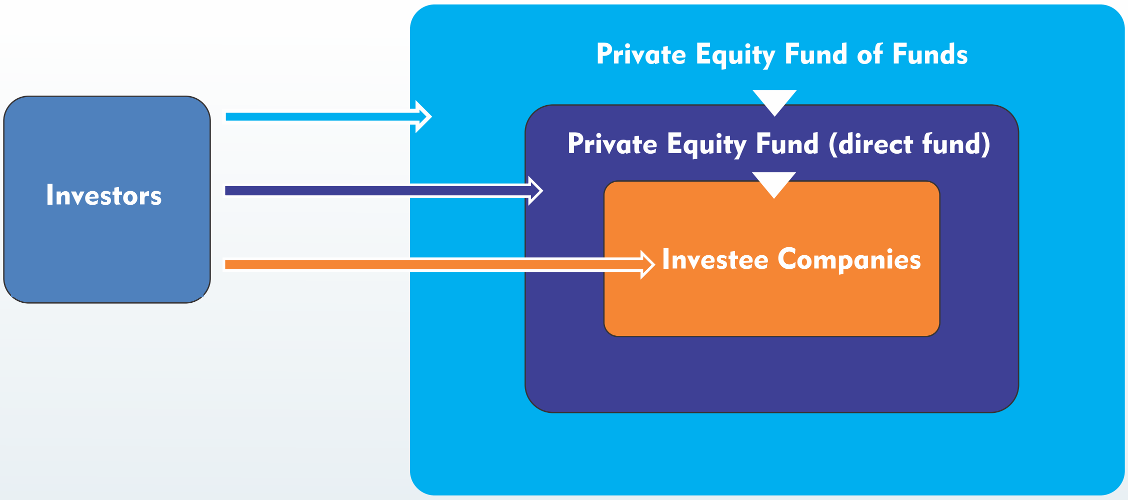
Options for creating private equity exposure

Investors in private equity can choose how they wish to gain access to this asset class. They can either;

i. Invest directly in companies
ii. Invest via specialist private equity funds (also known as direct funds) or
iii. Invest via fund of funds

[4]In 1987, most of Yale's portfolio—90%—was allocated to marketable American securities, like public stocks, bonds, and cash. Today only 10% of its endowment is invested in these kinds of assets. The rest is in hedge funds, private equity, foreign stocks, and real estate. An astounding 50% of Yale's endowment is invested in these types of illiquid, high-fee alternative assets.
[5] The external investors are called limited partners (LPs) because their total liability is limited to the amount they invest. They include; Private sector pension funds, Public pension funds, Foundations, Fund of funds companies, Insurance companies, Endowment plans, Banks and investment banks, Investment companies, Asset managers, family offices, government agencies, Corporate Investors, Private equity firms, Sovereign wealth funds, Wealth managers, Superannuation Schemes, etc.
[6]The consortium, which is designed to pool funds and invest in capital intensive infrastructure projects, has over USD 2b in assets.
[7] The manager is often called the general partner (GP) because they have unlimited liability for the actions of the fund. To put a cap on this potentially unlimited liability many GPs are in fact limited companies or partnerships.
[8]Common covenants include restrictions on how much fund capital can be invested in a single company, the types of securities a fund can invest in and restrictions on debt at the fund level.
[9] In the traditional structure of PEinvesting, PE funds are usually arranged as general partner - limited partner contract, where the limited partner (LP) supplies capital for the general partner (GP) to invest in its funds. It is customary for the GP to invest at least 1 % of the total capital required to the fund.
[10]LPs may also negotiate for preferential rights on subsequent investment rounds in exchange for helping the manager with the companies where they invest alongside the fund.
[11]A case is being made that CDC should never have invested in ARM - but rather could have done it via a PE vehicle
[12]Good examples include CBK's pension fund investing via Catalyst Partners, Kenya Power Pension Fund (KPPF) investing via Fanisi and Ascent Capital, etc.
[13] Brown, K. C., Garlappi, L., & Tiu, C. (2010). Asset Allocation and Portfolio Performance: Evidence from University Endowment Funds. Journal of Financial Markets Vol 13. (2) , 268-294.

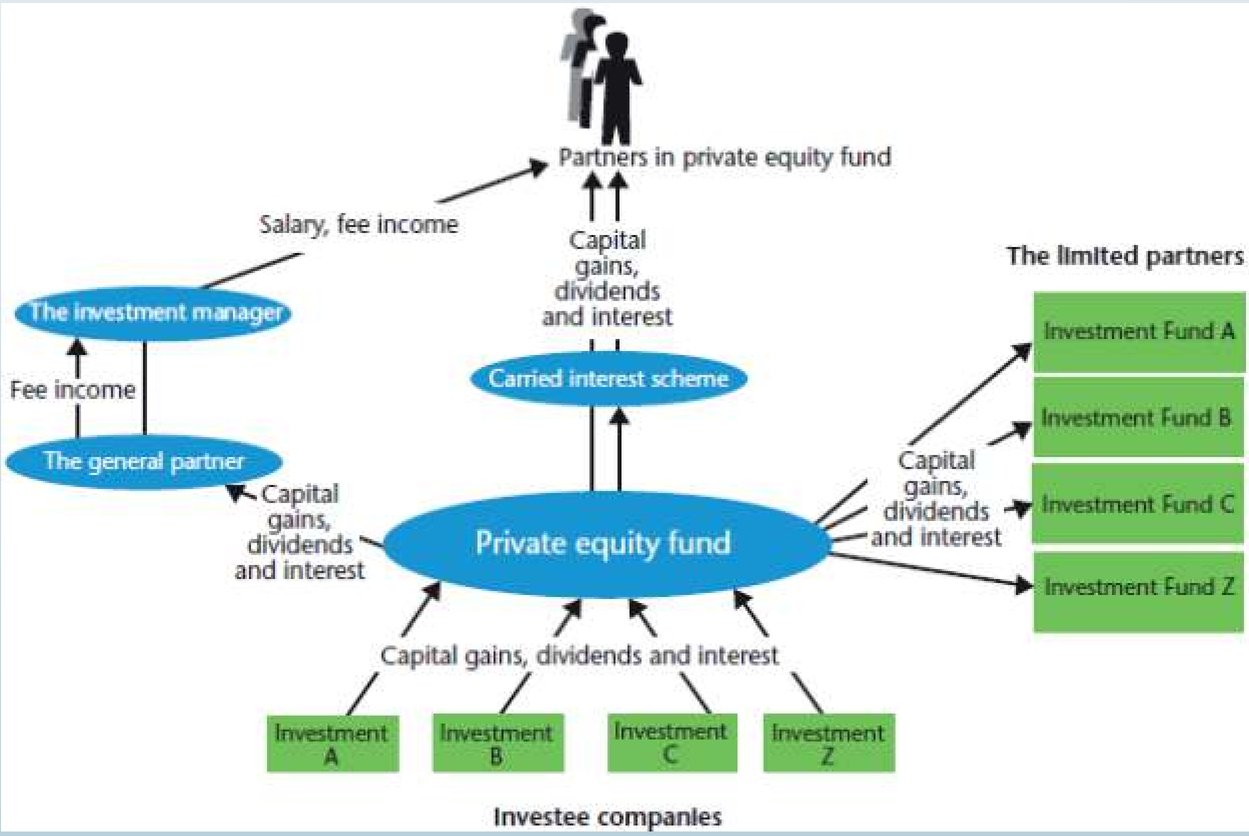
[14]According to McKinsey Global Private Markets Review 2019, valuation multiples have grown from 9.6x in 2015 to 11.1x in 2018, inching closer to the 2007 peak of 11.3x which is a major concern globally.
[15]Dry powder rises when commitments outpace deployment of capital.The survey by KPMG and EAVCA shows that in 2018, there was an estimated USD 600m of cash yet to be deployed. Globally, Preqin estimates dry powder levels at USD 1.5tr -the highest on record and more than double what it was five years ago.
[16] The size of a fund's dry powder is a useful indicator of its future investment patterns.




*Source: Author*

*The majority of investors invest via specialist private equity funds (also known as direct funds) that in turn invest in a series of companies.*

## Structure of a PE fund



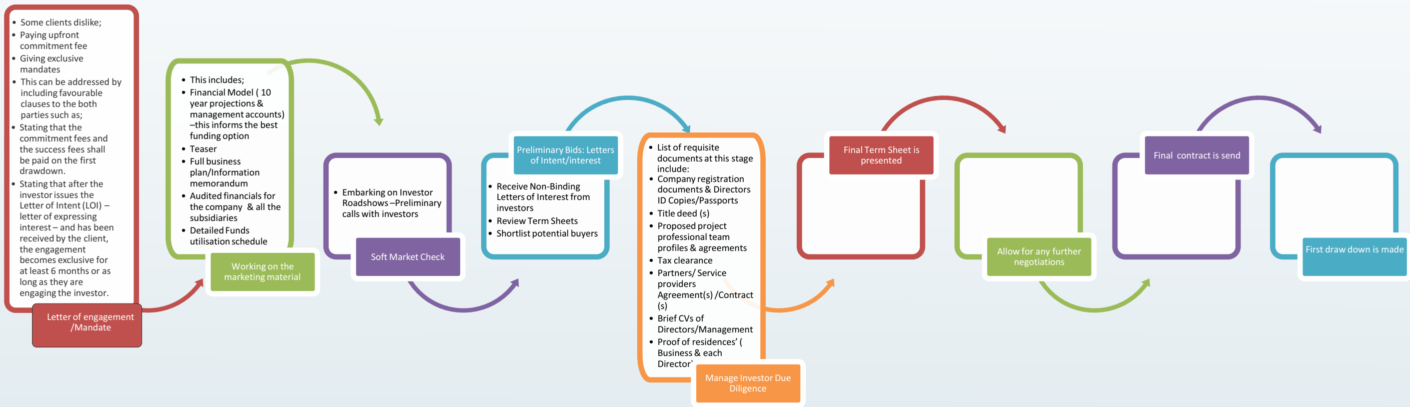

*Source: Gilligan and Wright*

As illustrated above, the GP manages one or more funds. These are invested in by a variety of institutions and other bodies (LPs). The funds have a limited life, meaning that there is a pre-agreed date on which they will stop making new investments and subsequently be wound up.

The fund manager itself may or may not be a partnership. However, each fund is usually a separate limited life partnership. There is much misrepresentation and confusion about why these structures exist. In essence the problem that needed to be solved was: how can a group of institutions and individuals create a structure that would bind them together as investors for a finite period without creating multiple tax charges? Note that the starting point is not to avoid tax; it is to avoid duplicating tax charges. Each investor should be taxed according to their individual tax position. The problem was to avoid creating a vehicle that would also be taxed before the investors were paid out.

## Steps in making PE investments

PE investments are made in a long but well thought out process as illustrated below.




# Conclusion

Although PE firms goal as a midwife is to hit the 10% threshold, getting there will take some time. Regulators need to go beyond regulation and work with industry players to create an environment that is conducive to innovation and resolving the myriad challenges faced in the financial world today.A country like Kenya whose economic outlook appear bleak (rising debt levels, revenue target shortfalls, high unemployment rate, multinational exits and business failure) and experiencing stagnating foreign direct investments ought to review its investment policy guidelines touching on maximum allowable limits on alternative asset classes such as PE for capital deployment by localpension managers. Investment guidelines should also be structured in a way to allow local LPs invest directly.These changes are bound to enhance portfolio diversification, boost fund performance and spur economic growth. In return, increased local pension funds PE investments will trigger company listings through capital markets exitsby some funds.

# ARTIFICIAL INTELLIGENCE HAS STARTED INVESTMENT AND FINANCIAL INDUSTRY REVOLUTION

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Financial and investment industry has grown over the last years in Kenya, which gave birth to the sector regulator ICIFA. The firms are now looking potential better and simplified ways for improving their investment decisions making models by use of their historical data.Some of the technological advancementsinclude Robot dexterity, Internet of Things (IoT) Artificial Intelligence (AI), Big data among others. In 1950s Artificial intelligence (AI) explored problem solving methods, out of this the US Defense Department started having an interest in what AI what it was doing and began training computers to imitating human reasoning, learn and solve problems. Today AI is becoming popular due to increased data volumes, advanced algorithms, and improvements in computing power and storage.

The financial and investments industry expects investments analyst to get ease in using technological products and services. AI and big data are taking over the human beings, drivers, receptionist and fund mangers; AI is making investment decisions globally. Two decades ago how many did even imagine that a mobile phone would give us the option to take selfies? This killed our very own huge Postal and Telecommunication Corporation and later Telcom. If we do not grow with the technological changes we shall die like this state corporation. It is a reality that with the increasing technological changes, the investment and financial industry should move with a faster speed to achieve these expectations.

> **AI can immediately identify investments opportunities shifting tasks from the human interference...**

Investment and financial Services sector depends mostly on specialized data collection, analysis and processing. Artificial intelligence can simplify all these through performing financial analysis as you do, helping investments analyst with tasks that rely on gathering and interpreting reams of information which can be set at intervals and the reports will be available any required time. Using Artificial Intelligence systems you will be able to know and detect and monitor all the financial irregularities made in your organization, though historical data processing and other unclear activities. Assessment investment risks are simplified through prediction of prices volatility and trading analytics.

AI can immediately identify investments opportunities shifting tasks from the human interference, made possible by informing the analyst about it via a visual representation of key factors derived from the AI engine. AI-based competitive analysis models are able to track your competitor's business models, their strengths and weaknesses that will help you develop a clear competitive edge. As an investment analyst you are able to provide your structured and unstructured data and derive critical insights, this will help in making clients investment decisions as well as predict future business outcomes. The algorithms transforms the existing risk frameworks to mitigate more risks in a more better way, through building of data models that will help in improve decision making process while managing risks.

It will be difficult to know how investments and finance industry will look like, when human being judgment is taken over by AI and Machine learning, in the end; it will be a good thing for the financial analyst. Ordinarily fund managers are emotional with psychological challenges while managing portfolio, The AI algorithm doesn't have them, it removes out the natural kind and human reasoning, thus reaching more objective conclusion. We appreciate the AI limitations and human being weaknesses but we believe combining both models will shape investments and finance industry.

With all these AI is going to change the industry for better, but we also must appreciate its limits. AI gets its raw materials from data, thus any inaccuracies in the data given will be reflected in the results. All AI systems are programmed to do a clearly defined duty, the system that detects fraud cannot give you legal services, and system that detects health care fraud cannot detect tax fraud. Simply AI systems are very specialized and focus on a single given task thus far from achieving man brain that normally cannot multi-task like woman. Through enabled AI-based systems, investments firms can generate alpha, the excess return that measures the market's systematic risk. This will help in making accurate decisions and to allocate capital in the right way for enhanced value creation.

I'm a fan of automating everything possible, AI in Financial and Investment industry depends on continuous learning of patterns and data interpretation. As the industry players we should embrace AI, Big data and Machine learning and we will get better and smarter. Having an informed analyst with sound judgment at the end of the automation process is a good thing. Although it is not the right time to replace human analyst, we should ask ourselves some few fundamental questions. What actions are you taking to incorporate AI in your analysis skills? Where do you see AI adding value to you?

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# UNDERSTANDING THE OIL PRICE DECLINE AND FUTURES MARKETS

FA Terrence Adembesa

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A derivative contract is an agreement to engage in a commercial transaction in which the delivery of an asset is set for the future, while the price and various specifications of the contract are agreed at the time of contract initiation. These markets originated from burgeoning oil and grain markets. In the agricultural markets, these created a need for a farmer to secure a price at one point in time, store the grain, and deliver it at a later point in time. Despite these markets initially being dominated by agricultural commodities, globally there has been a proliferation of other financial instruments such as currencies, bonds and stock indices. Although the commodity derivatives markets include very active contracts in oil and precious metals, financial derivatives have remained the most traded instruments in the global derivatives markets.

Types of derivatives include forward and futures contracts. In a forward contract, the agreement is made between two parties in which one party, the buyer, agrees to buy from the other party, the seller, an underlying asset at a future date at a price established at the start. The parties to the transaction specify the forward contract terms and conditions, such as where delivery will take place and the precise identity of the underlying. In this sense, the contract is bilateral and customized. A futures contract is a variation of a forward contract that has additional features such as making it a standardized and public transaction that takes place on a futures exchange. The futures exchange thus determines the expiration dates, the underlying, how many units of the underlying are included in one contract and various other terms and conditions.

On entering the transaction, being a publicly traded security, the exchange enables the trading and settlement of the contract through a daily mark – to –market procedure. Profits and losses are charged and credited to participants' accounts each day, preventing the accumulation of losses for the party on the losing side of the trade. This process would continue on a daily basis until expiry or until either party engages in an offsetting transaction – engage in the opposite transaction. On expiry, the contract can be settled for cash or physical delivery of the underlying asset. The futures exchange ensures the sanctity of such markets by interposing itself on such trades and settlement procedures.

The primary functions of such markets is to provide key information about the prices of underlying asses, for example, the price of the contract with the shortest time to expiry serves as a proxy for the price of the underlying asset. Further the price of a futures contract serves as the price that can be accepted by those who trade in the contract in lieu of facing the risk of uncertain future prices. But most importantly, the function of futures markets is to hedge by seeking to avoid the uncertainty of future prices by locking in a price for a future transaction. A farmer unsure of the price of his crop at harvest could enter a futures contract with a miller to lock in the price on delivery. The farmer has concerns about a price decrease while the miller would be worried about a price increase.

As you may note, these markets work well due to the convergence of derivative prices with the prices in the spot (physical) markets. This is enabled by the delivery mechanism that exists in which a transfer of cash or the physical commodity occurs. When it comes to oil, there are different grades. The popular being the Brent Crude and the West Texas Intermediate (WTI). Brent is produced in the oil fields and other sites in the North Sea. WTI is usually extracted from US Oil fields in Texas, Louisiana and North Dakota. Brent Crude is the international benchmark price used by the OPEC while WTI crude price is a benchmark for US oil prices. Most of the oil imported in Europe, Africa and the Middle East is priced according to the cost of Brent Crude. It is the reference for about two-thirds of the oil traded around the world and hence slightly more sensitive to various factors such a geo-political tensions. As it is produced near the sea, its shipping costs are typically lower. However, the shipping of WTI is higher since it is produced in landlocked areas, where the storage facilities are limited.

On Monday, April 20 2020, the WTI crude prices fell below zero for the first time ever. It settled at negative $37.63. This was driven by a trading deadline on the May expiry WTI futures contract. Driven by the expiry, traders were desperate to get buyers for the barrels of oil. Some traders were willing to pay as much as the $37.63 to accept delivery of one barrel of oil.

During normal periods, traders would offset these contracts and roll on to those of the future months. The concern being that buyers that had the ability to receive and store that much oil are in short supply.

This is really attributable to the Coronavirus pandemic that has led to an extreme sharp drop in the demand for oil. It has created a massive oil glut and raised concerns about the lack of physical storage space for it.The US oil that is located in different unconventional pooled deposits require more invasive, energy intensive production techniques. Add on to this, the reliance on borrowed capital makes it difficult to cut oil production. With the oil surplus lacking storage, analysts fear that US storage could be at 70-80% capacity. Many producers may thus be forced out of business leaving wells idle.
With the expiry of the May 2020 contract, we expect the June 2020 contract to be pulled lower over coming weeks unless a cure for the Coronavirus is reached and/or governments are able to lift travel restrictions and business closures resuscitating global oil demand.

Terry Adembesa
Chief Officer, Derivatives Market
Nairobi Securities Exchange

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