CAPITAL MARKETS AUTHORITY

Promoting the Integrity and Growth of the Capital Markets

COLLECTIVE INVESTMENT SCHEMES

Background

The Kenyan capital markets space has greatly developed in the last few years. Apart from the traditional capital markets products, that is, bonds and shares, there are more products from which prospective investors can choose from. One of the more exotic products is called a Collective Investment Scheme. This brochure is intended to educate and impact the reader with all there is to know when it comes to CIS's, the abbreviated form.

1 What are Collective Investment Schemes

Collective Investment Schemes are pools of funds that are managed on behalf of investors by a professional fund manager. They are arrangements made by or offered by any company under which the contributions, or payments made by the investors, are pooled and utilized with a view to receive profits, income, produce or property and is managed on behalf of the investors.

The manager uses the money to buy stocks, bonds or other securities according to specific investment objectives that have been established for the scheme. The mode of sharing returns arising from the investment is agreed upon via a contract before pooling of funds. There are four types of Collective Investment Schemes today, that is: Unit Trusts; Mutual Funds; ESOPs (Employee Share Ownership Plans) and Stocks.

2 What is a Unit Trust?

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3 What is a Mutual Fund?

A Mutual Fund is a professionally managed type of collective investment scheme that pools money from many investors and invests it in stocks and other securities. It is a collection of stocks or bonds, and other money market instruments. This happens when a large number of people give their money to professionals, to manage and invest with the aim of achieving a return and in accordance with the objective of the fund. Mutual funds are also governed by the Capital Markets Act as read with the Capital Markets (Collective Investment Schemes)

Regulations, 2001. They are collective investment schemes set up as a body corporate where investors invest in shares. Mutual Funds are operated by professional managers, and the portfolio is structured and maintained to match the investment objective stated in its prospectus. (note that Mutual Fund structures are not yet in place)

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4 What is the difference between a Mutual Fund and a Unit Trust?

The main difference between the two is in their legal structure. A mutual fund is an investment company that issues redeemable shares while a unit trust, because it is not a company, only issue units.

5 What is an ESOP (Employee Share Ownership Plan)?

An Employee Share Ownership Plan (ESOP) is an employee benefit plan that gives workers ownership interest in the company. ESOP's give the sponsoring company, the selling shareholder, and participants various tax benefits, making them qualified plans. Companies often use ESOPs as a corporate-finance strategy to align the interests of their employees with those of their shareholders.

Simply put, an ESOP is an option by employees of a company to buy the shares of that company at a price that is prescribed by the company. Normally, to make the ESOP more attractive, it is usually priced lower than the market price. The company normally has the right to determine the number of shares that the employee gets, which employee gets them and whether the ownership is actually transferrable. It is normally given to high calibre employees as a way of motivating and retaining them since they become shareholders to the company.

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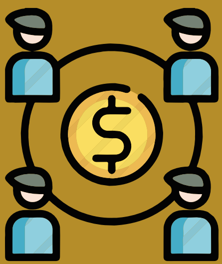
6 How are Collective Investment Schemes Regulated?

Only Collective Investment Schemes that are approved by the Capital Markets Authority may be offered for sale to the public. Such schemes must comply with the Capital Markets Act Cap 485 A and also the Capital Markets (Collective Investment Schemes) Regulations, 2001. An approved fund can be easily identified by the cover of its prospectus which contains a statement stating that a copy of the prospectus has been lodged and approved by the Capital Markets
Authority.

Always carry out your own due diligence before depositing your money with any financial advisor to ensure that the investment advisor is regulated by the Authority.



7 Checklist for Prospective CIS Investors

i. As with all the other capital markets investments, understand your individual risk appetite, investment objectives and buffer capital before selecting a CIS vehicle.
ii. Read the prospectus carefully. Make sure you understand where and how your money is to be invested and the risks involved. You should be aware of how a unit trust or mutual fund works, the charges and the fees involved and your rights and responsibilities as a unit holder.
iii. The fund's investment objective and strategy, investment limits, its current portfolio and any commentary on its recent performance. This should also give you a rough idea of the risk level of the fund.
iv. Check the past performance of the fund. Do not pay too much attentions to periods of an year or shorter. Remember, investments should always be treated as a marathon, not a sprint.
v. Look for good and consistent performance for the longer term. Be warned that the past success of a fund is no guarantee of good performance in the future.
vi. See if there are any specific features and constraints which may conflict your needs of preferences. For instance, some funds may have a policy of not distributing dividends, the minimum investment may also be higher than what you may want to invest or the procedures for buying and selling of units in the fund may be inconvenient.
vii. When deciding which fund to invest, you should also look for information on the shareholders, board of directors and key management staff of the fund management.
viii. You should assess the financial strength, track record and expertise of the company and its staff.

8 What are the Benefits of Participating in a Collective Investment Scheme?

i. Collateral: securities represent stocks of wealth and used as collateral to secure financing such as loans from lending institutions.
ii. Confidentiality: Investing in securities guarantees confidentiality in the management of wealth, as financial securities are intangible in nature.
iii. Flexibility: Shares are traded in units and lots that are affordable by investors of different income levels. Bonds are also fairly affordable with a minimum of Kshs. 50,000 when compared to alternative investments such as real estate. As such, investment in securities can be customized to the specific incomes of investors.

50,000

Minimum Kes for bond

iv. **Professional Management:** Mutual funds/Unit trusts are managed by professionals who are experienced in investing money and who have the skills and resources to research many different investment opportunities. Investors in these funds, therefore, get access to the professional management of their funds.

v. **Operating Convenience:** As investing in securities represents the separation of ownership from management, it therefore does not require the personal commitment of the investor for it to give a return. Investors are therefore saved the occupational hazards of careers, as opposed to other businesses that need the personal presence and involvement of the entrepreneur.

vi. **Liquidity:** Shares and bonds are easily transferable at low transaction cost as compared to other assets such as real estate. Therefore, an investor can buy and sell at considerable convenience.

vii. **Hedge Against Inflation:** Securities prices over the long term tend to outperform inflation, therefore investment in securities can be a reliable hedge against inflation in the long term.

viii. **Spreading of Risk and Maximization of Returns:** The range and variety of securities listed in stock exchanges provide investors an opportunity to minimize their exposure to specific company risk by spreading their investments across a wide selection of stocks. This benefit is made more concrete using Collective Investment Schemes such as Mutual Funds and Unit Trusts, which invest pooled savings using specialized expertise that is beyond the ability of an individual investor.

For further information, please contact:

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