Education Investment Plans in Kenya, & Cytonn Weekly #07/2020

Focus of the Week

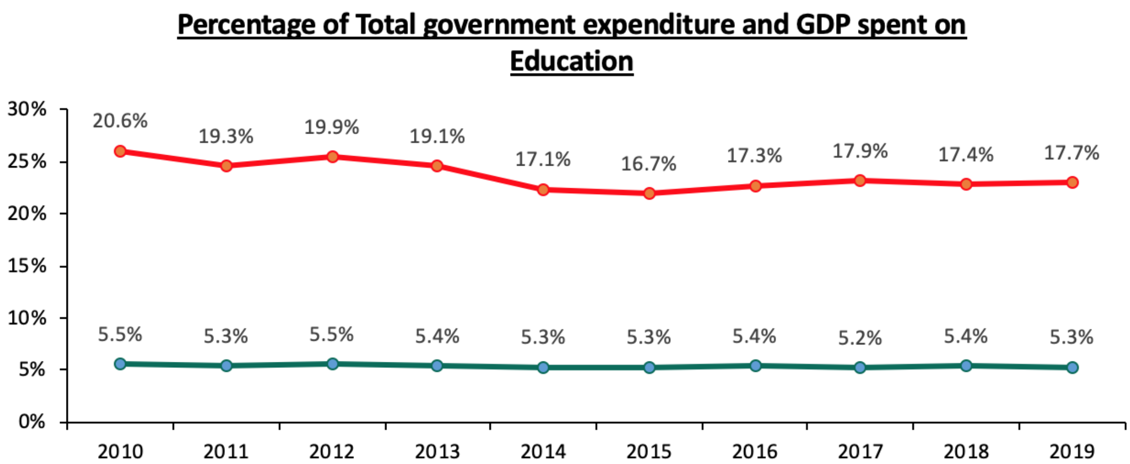
This week, we seek to analyze education investment plans, why one should invest in an education plan, some of the options available for investors and the various factors that come into play when selecting an education plan. We also focus on asset allocation strategies that fund managers employ when investing the funds in education investment plans. We do this in six sections as follows:

1. Background of Education Sector and Laying of Context,
2. Enrolment and Literacy Statistics Globally and in Kenya,
3. Constitution of Education Investment Plans,
4. Key Things to Consider before Joining an Education Investment Plan,
5. Alternatives to Education Investment Plans, and
6. Conclusion

Section 1: Background of Education Sector and Laying of Context

Education is a key aspect in any economy, with the Kenyan government making significant allocations towards education expenditure in every fiscal year. Over the last 10-years, the budgetary allocation towards education expenditure as a percentage of GDP has been averaging over 5.3%. According to the FY'2019/20 budget reading, the education sector received a significant share of government spending at Kshs 494.8 bn, out of the total budget of Kshs 2.8 tn, (equivalent to 17.7%). According to the 2020 Budget Policy Statement, this is expected to increase to Kshs 497.8 bn in FY'2020/21, Kshs 528.4 bn in FY'2021/22 and to Kshs 544.2 bn in FY'2022/23.

Below is a chart showing a percentage of education expenditure against total government expenditure (red line) and against GDP (green line):

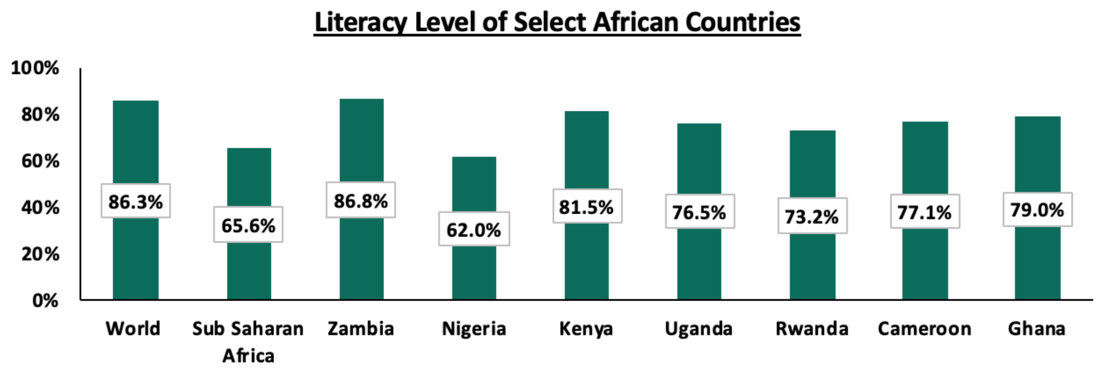


Education enables citizens to get better jobs in the market and empower those who do not get employed to start their own businesses. The skills equipped by secondary and university education especially are enough to make one self-sufficient. Employment on the other hand empowers Kenyans to improve their standards of living and collectively that of the nation… There is no limit to the potential that education holds hence why the government continually spends on the sector. This has increased access to quality basic education and improved the outcomes of our public schools as seen in high literacy levels ranking among peer nations. In particular, Kenya has the highest rate of primary-to-secondary school transition, which is currently close to 100.0%. Education however has a huge cost implication that needs addressing. With primary education being mostly free, it is post-primary education that many guardians need to save for to enable their children gain quality education, hence the need for education investment plans.

Section 2: Enrolment and Literacy Statistics Globally and in Kenya

Literacy level refers to the total number of people in a country or region who are able to read and write. Kenya has had a high literacy level from the beginning of century to date currently estimated at 82.0%. This may be attributed to the free primary introduction and the importance that its citizens place on education.

The graph below shows the literacy level of select African countries and the Sub-Saharan and the world averages.



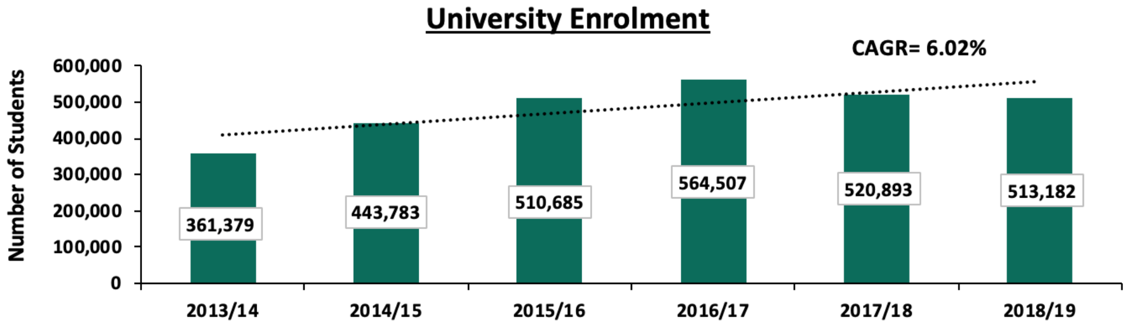
Source: World Bank – World Development Indicators (WDI)

Kenya has a literacy level of 81.5%, which is higher than the other select African countries except for Zambia, which has about 86.8%. The world average is 86.3% while the Sub Saharan average is 65.6%.

The biggest constraint to quality education, however, has been the cost implication on guardians. The introduction of free compulsory primary school education during the previous regime has offered some reprieve to guardians, albeit minor. They still had to contend with costs such as purchase of books and reading material, exam fees, boarding fees and others. On top of it, this waiver of tuition fees drove an influx of students to public schools, causing an issue of overcrowding and in effect deterioration of the quality of education. Most guardians opted to go the private school route, despite being costly, to ensure their children get the best education.

Recently, there has been a stagnation and further decline in the number of students joining universities from secondary schools. This has put pressure on public universities' cash flows causing various public universities to start focusing more on parallel programs in order to avoid revenue shortfalls. This raises fear that the cost of university education may become significantly higher in the next five to ten years. On top of that, the alternative, parallel programs, is more expensive than government-sponsored courses.

Below is graph showing university enrolment numbers in the last 6 years as researched by Kenya National Bureau of Statistics:



Source: Kenya National Bureau of Statistics Economic Survey 2019

Companies in the financial services sector have taken the opportunity to address these issues by tailoring products (Education Investment Plans), aimed at helping parents save and invest with the goal of securing their children's education.

Section 3: Constitution of Education Investment Plans

Education Investment Plans are medium to long-term mutual funds promoted by a financial institution, usually an insurance company or an asset manager. In terms of structures, Education Investment Plans are easily distinguishable in that they often have a lock-in period of investment whereby the guardian is required to make periodic contributions, usually monthly. These funds then gain interest and help the contributor attain their financial goals. The beneficiary of the funds could be a dependent or one may save for their own education.

Education Investment Plans have a relatively longer lock-in period, which help to promote investor discipline. Ideally, an investment plan that caters for a long-time goal should have low liquidity. In Kenya, most market players have set the minimum tenor at 5years. This serves the logic that most parents and guardians save for secondary and university education and they often start saving early on. The plans require a minimum monthly investment amount ranging from Kshs 1,500 to Kshs 7,000. However, the payments are flexible in that one may pay monthly, quarterly, semiannually or annually.

Below is a list of some of the existing education plans in Kenya:

Education Plan	Minimum Investment Period	Minimum Investment Amount	Interest Rate per annum	Minimum Sum Assured	Life Cover Benefits
Jubilee Career Life Plan	5 Years	Kshs 5,000	5.6%	Kshs 350,000	• Accidental death • Waiver of premium • Accidental hospitalization • Sum Assured • Last Expense
Liberty Scholar Plan	15 Years	Kshs 1,500	No interest rate. Bonuses payable	Kshs 200,000	• Sum Assured • Waiver of premiums
Liberty Educator Plan	10 – 20 Years	Kshs 1.000	No interest rate. Bonuses payable	Kshs 200,000	• Sum Assured • Waiver of premiums • Student Accident Cover • Disability Benefit
Britam Elimu Bora Education Policy	7 – 18 Years	Kshs 1,500	10%	Varies according to contributions	• Sum Assured • Disability Benefit • Hospitalization Benefit • Family Income benefit • Last Expense
Madison Bima Ya Karo	10 – 18 Years	Kshs 2,500	2% (Guaranteed)	Kshs 119,000 (May vary according to Age)	• Sum Assured • Waiver of premiums
Madison Uniplan	5 – 15 Years	Kshs 5,000*	5% (Guaranteed)	Kshs 394,000	• Sum Assured • Waiver of premiums
Capex Masomo Cover	5 – 20 years	Kshs 2,000	6%	Kshs 120,000	• Last Expense • Sum Assured • Waiver of premiums
CIC Academia Policy	5 Years	Kshs 2,000	5.8%	Vary according to age	• Last Expense • Sum Assured • Waiver of premiums
Wanafunzi Trust by Nabo	4 Years	Kshs	8.4%	No life cover	N/A

Education Plan	Minimum Investment Period	Minimum Investment Amount	Interest Rate per annum	Minimum Sum Assured	Life Cover Benefits
Cytonn Sharp Education Investment Plan (SEIP)	3 – 10 Years	Kshs 100,000**	15%	No life cover	N/A

**Kshs 5,000 minimum investment comes with a term condition of minimum of 6-years (Madison Uniplan)*
*** This is a privately offered and distributed product, hence the higher minimum amount to comply with Reg. 21*

From the above table, the below are the key take-outs:

- Insurance companies all provide life insurance together with their education policies. The sum assured in this case refers to the amount that is paid out to a client's next of kin should they die. This amount varies with the monthly contribution amount and the tenor of investment. These insurance companies incorporate life insurance premiums into the monthly payments in order to avoid clients making two separate payments,
- Insurance Companies however, offer less returns than education products by investment managers. This is mainly because education policies in insurance companies are taken as more of a savings plan rather than an investment plan,
- The minimum investment amounts vary from Kshs 1,500 to Kshs 5,000

Life cover does not refer to a lump sum paid upon death (sum assured); Instead, the life cover comes with extra benefits called riders. The riders include:

1. **Last Expense** – Upon death, the surviving beneficiaries are paid an amount, usually about Kshs. 100,000, within three days to help cater for funeral expenses,
2. **Permanent and Total Disability (PTD)** – This benefit accrues to when the client suffers a disability hence affecting their ability to continue contributing to the education policy. The client is offered a lump sum and given their funds plus accumulated interest,
3. **Accidental Life Cover** – This refers to when a client passes away in a purely accidental manner. The beneficiaries are paid a lump sum on top of the funds already saved,
4. **Natural Death** – Natural death life cover refers to when a client dies form natural causes such a disease. The difference between natural death and accidental life cover is that in natural death the beneficiaries have to produce a death certificate and other documents confirming cause of death. The processing of these documents may take two months or longer, and,
5. **Family Income Benefit** –This rider provides a monthly income for the family after the client passes away until the policy matures.

Education policies offer flexibility in that a client may choose to contribute monthly, quarterly, semiannually or annually. If a client is able to, it is advisable to pay annually in arrears, as the interest accrued for the year will be higher.

Lastly, Kenya also has a tax incentive for Education Plans but with the condition that one must save for a minimum of 10-years. The tax incentive allows for tax-deductible contributions of up to Kshs. 5,000 per month.

Recently, we have seen the monopoly set by insurance firms challenged with new entrants into the market. In 2019, Nabo Capital launched Wanafunzi Investment Unit Trust Fund, which allowed students to save for their own education. Unlike the other education policies that are offered by insurance companies, Nabo Capital is an investment firm. Cytonn also provides its own education plan, Cytonn Sharp Education Investment Plan that offers a return of 15% per annum with a lock-in period of 3 years, but the product is a privately placed product.

Section 4: Key Things to Consider before Joining an Education Investment Plan

According to research done by Cytonn on priorities accorded to various household expenditures, food is the first ranked priority at 81.9%, followed by rent with 67.3%, then school fees with 29.6%, transport at 27.1% and the least prioritized is entertainment with 3.9%. School fees herein represent expenditure on education; add to it the costs of student accommodation and reading materials and the total expenditure rises even further. Bearing in mind these costs, a guardian has to choose an education plan that can provide safety, preservation and growth. The following are key factors to consider:

1. **Financial Profile of Investor:** This refers to the different and unique characteristics each investor has. Age is an important factor to consider before making any investment decisions as it affects both the time horizon of an investment that an investor is willing to take and their risk appetite. A young couple with a young child can choose to invest in a longer education plan, while an older couple with more mature children does not have the need for saving for such a long time. A longer tenor also affords the younger couple the opportunity to have a more aggressive portfolio as they have more time to recover any lost potential returns. It is also key for guardians to profile themselves based on the financial goals they hope to achieve with the investment plan. If they want to invest for a short period they should consider other investment vehicles whereas if they would like a longer-term investment then education investment plans are the best option for them,
2. **Issuer:** It is especially crucial when seeking a financial partner to do a background check with a keen focus on returns offered. Education plans are often long-term investments that are hard to get out of. One should think about whether to buy an insurance based product or an investment manager based product,
3. **Inflation:** The value of money now is higher than a similar amount in the future due to the effect of inflation; to ensure that you preserve the strength of your education savings, it is important that you save in a plan that offers above-inflation interest rates. Inflation refers to the continuous rise in prices of commodities and services. This means that if you were saving towards university fees, say Kshs 1 mn, then the fees in 10 years would be higher for the same service. It is recommendable to have a financial goal higher than the current market conditions. Guardians should also save their money with an issuer who offers interest rates significantly higher than inflation rates to cushion inflationary effects,
4. **What to Do With Funds When The Kid is In School:** When the term of the education plan comes to an end and the dependent is going to his or her desired college, it is highly probable that the matured funds will be more than enough to cater for the college fees. The guardian can either choose to pay the school a lump sum or alternatively pay the fees for the current year or invest the rest in a liquid investment product,
5. **Additional Benefits:** Most education plan are provided by insurance companies. The insurance companies offer their education policies clients with the additional benefits of life cover which is sometimes subject to payment of an additional premium. Life insurance serves to provide financial protection to the loved ones left behind and it is important to consider before saving in a plan. The guardian may also choose to have the education plan and the life cover separately with different firms,

6. **Early Withdrawal:** One key area that an education policy client should be able to appreciate is the fact that as a medium-long term investment, it is difficult to have early access to all of your funds anytime as one wishes. In education policies offered by insurance companies, there is a term known as surrender value. This is the amount that one stands to be paid should they wish to withdraw early on in their policy before maturity and this value is usually significantly less than the aggregate contributions. However, there is an option called ‘Paid up’ which allows the client to no longer contribute monthly payments without penalties. To better understand, we shall take an example of plan offered by a market player, ABCD education policy: For this policy the minimum tenor is 5 years; however, for a client who has faithfully contributed every month (or quarterly, semiannually or annually) for 3 years they are offered the Paid Up option. Should they choose this option, for the remaining 2 years, their money will continue earning interest but they will not be required to contribute.

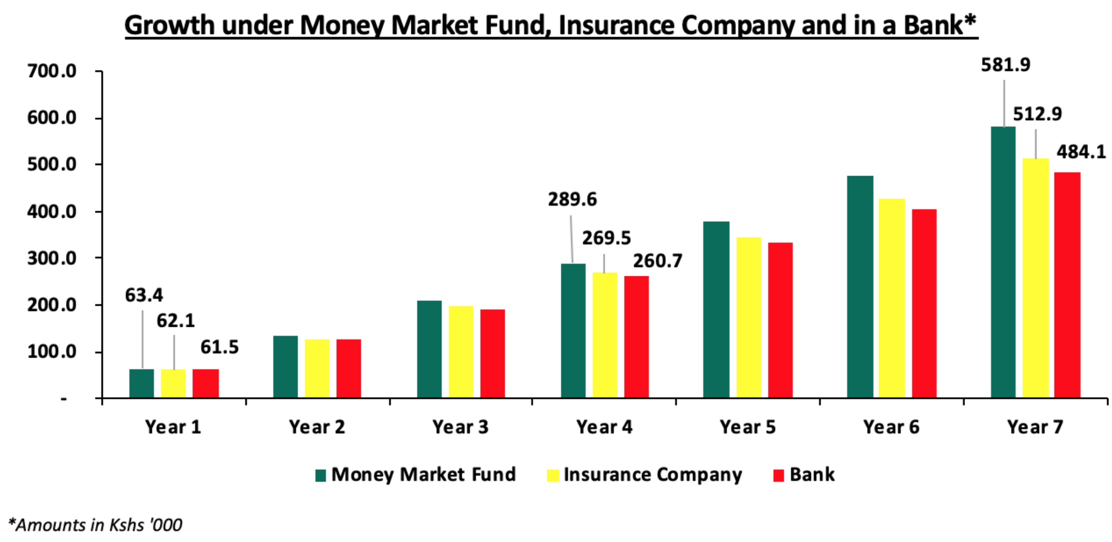
Section 5: Alternatives to Education Investment Plans

Education Investment Plans are versatile investment avenues that cater for clients of varying risk appetites. However, to save for education one does not have to use a purely education-oriented product.

Other ways of saving for education other than Education Investment Plans include:

a. **Money Market Fund**: A money market fund is a short-term investment vehicle that offers high liquidity as the lock-in period is usually short and withdrawal is easy (most money market funds typically allow redemption within four working days). However, there is no tax benefits associated with money market funds, however the higher rates of returns more than compensate for the lack of tax benefits. Additionally, money market funds offer easy withdrawal that allow you to redeem regularly say, every term or semester or to cover educational emergencies that may arise in the course of the investment period. However, a specialized education based unit trust fund would likely limit withdrawals,
b. **Banks**: Many banks in Kenya offer targeted savings account for saving for various goals including education. These accounts have seen a high uptake as many Kenyans consider banks to be safe options and fail to pay enough attention to the returns they get.

To illustrate the different returns one would get under various alternatives we have assumed a person who starts with an initial investment of Kshs 10,000 and makes monthly top-ups of Kshs 5,000 saves in a money market fund, with an insurance company and in a bank savings account. Below are the amounts at maturity they would get:



Analysis of Education Investment Plans

	Money Market Fund	Insurance Company	Bank
Initial Amount (Kshs)	10,000	10,000	10,000
Monthly Top-ups (Kshs)	5,000	5,000	5,000
Tenor (Years)	7	7	7
Rate of Return	10.09%	6.29%	4.5%
Amount after Maturity (Kshs)	**581,877**	**512,893**	**484,066**

Sources: Money Market Fund Interest Rates – Effective annual interest rates of the top 5 money market funds i.e Cytonn, Zimele, Nabo Africa, Sanlam and AlphaAfrica Kaisha money market funds
Insurance Company Interest Rates – Average rates of Jubilee, CIC, Madison, Capex and Britam education investment plans as provided in the table in Section 3
Bank Savings Rate – Central Bank of Kenya release, November 2019
More information: The figures at maturity are gross and no taxes have been applied, and the interest rates are compound interests.

Evidently, the returns from saving in a money market fund are the highest. At the end of 7 years, saving in a money market fund will give returns of Kshs 581,877 compared to Kshs 512,893 and Kshs 484,066 when saving in an insurance education policy and in a bank savings account. A savings account should not just preserve your capital but it should grow with you and your needs.

It is essential that before making any investment decision to consult a financial advisor in order to better understand what you are getting into, before signing any binding agreement.

Section 6: Conclusion

Despite the economic uncertainties, guardians are still certain that they have to spend on their children's education to secure them a brighter future. In order to do this, they have to plan their finances accordingly and one of the best avenues for this is in an Educational Investment Plans. Education Investment Plans are not used to safeguard a child's education only but also, to save for one's own further education like Masters.

Prominent benefits that an Education Investment Plan include:

- **Shield Against Capital Erosion and Inflation Pressures** - Investing in a plan that offers high yield (higher than yearly inflation rates) enables one to protect their savings from erosion, i.e. what happens when the interest rate your money is earning is less than inflation rate for a given year,
- **Debt Management** - An education investment plan may enable you order to avoid future loans that your children or dependent will have to pay as they start working such as Higher Education Loans Board (HELB) loans. Upon reaching university, the student will not find himself or herself in a situation where they have to take a loan for their studies, as the education investment plan would cater of that. This avails more cash to the students when they start working as the monthly HELB loan repayment amount may be saved or even invested,
- **Serves as a Contingency Measure** - With tough economic times affecting your business or job security not assured, a parent can rest assured that they will be able to provide for their dependent's education should their source of income be affected, and
- **Compound Interest Benefit** – Most Education Investment Plans provided by fund managers earn compound interest. Compound Interest will make invested funds grow at a faster rate than simple interest, which is interest calculated only on the principal amount. Assuming an investment with an interest rate of 10%, for 5 years and an initial investment amount of Kshs 100,000 with no top ups, with simple interest the amount at maturity would be Kshs 150,000 while with compound interest the amount would be Kshs 164,861.

Most education savings plans are insurance-based, we suggest that guardians consider all options available in the market.