



## An Update on Financial Year 2012

A year of challenges has passed..yet another awaits..

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The GDP growth over the past few years has remained under 4% and this Financial Year 2012 also ended with subdued economic performance. The GDP growth for 2011-12 has been estimated to be 3.7% as compared to 3.0% in the previous fiscal year. The inflation rate (CPI) has averaged at around 11%, while the budget and current account deficits have been around 6% and 2% of GDP respectively. The KSE-100 Index closed at 13,801.41 in June 2012 and the discount rate closed FY 2012 at 12% after being reduced a couple of times by the State Bank of Pakistan during the year. The economy has, however, shown resilience while facing issues such as law and order situation, acute power shortages and natural calamities.

Despite the uncertain political conditions, unstable equity market and volatile interest rates, the Asset Management Industry grew by 53% during the year, and stands at PKR 380.5 billion which is just a few steps away of surpassing its historic high level of PKR 390 billion. The growth in the total net assets was mainly driven by the Money Market Funds which remained the fund managers and investors favorite choice followed by Fixed Income Funds; investing primarily in Government Securities.

As of June 30, 2012, the total Assets Under Management compared with the Bank Deposits were only 5.94%, which itself has grown since last year from 4.44%. The fund managers have invested PKR 168 billion in T-Bills out of a total of PKR 2,592 billion. The contribution towards the PIBs have been only PKR 1.95 billion out of a total outstanding amount of PKR 948 billion as of June 30, 2012. Out of the total assets under management, the mutual funds industry is invested in the Karachi Stock Exchange with PKR 78 billion out of the total market capitalization of PKR 3,235 billion of the KSE-100 Index.

### Equity Market

The fiscal year 2012 started on a negative note for the equity market but by the end of the year it achieved the highest level since the economic downturn of 2008. During the fiscal year, the KSE-100 Index gained 1,300 points, closing at 13,800 points. However, the average daily turnover declined to the decade's low of 80 million shares. Low volumes still remain a reason to worry as the market illiquidity is restricting the fair price discovery. As the prices of most of the shares in the stock market are reflecting the economic and political risks, the upcoming national elections may give a boost to the stock market, both in numbers and morale. Despite deteriorating political conditions, global economic slowdown and ongoing concerns about inflation, trade deficit and a weakening rupee, KSE-100 Index was still able to cross the 14,000 points level and made a high of 14,617.97 on May 7, 2012.

The Karachi Stock Exchange (KSE) has proposed various measures to revive trading activity; relaxing Capital Gain Tax (CGT) regulations being one of them which has received a good response from all the stakeholders including the Federal Board of Revenue (FBR). This will not only bring depth in trading volumes and price discovery but it will also eventually broaden the tax base. Another significant measure taken during the year was the demutualization of stock exchanges, converting the structure of the exchange from non-profit, mutually owned organization to for-profit entity owned by shareholders. It is expected to increase transparency and greater balance between interests of various stakeholders by clear segregation of commercial, regulatory functions and separation of trading rights and ownership rights. Demutualization is a well-established global trend and almost all stock exchanges worldwide operate in a demutualized set up.

### Debt/Money Market

Money market remained tight throughout the year with significant challenges on both external and fiscal account, leaving State Bank of Pakistan (SBP) with no option but to conduct regular OMOs to pump in

liquidity. The Government's budgetary borrowing increased by 48%, as compared to last year. A total of 25 T-bill auctions were held by SBP during the year in which a total amount of PKR 3,221 billion was raised. The Government borrowed Rs. 226 billion through PIB auctions during the year.

Inflation on year to year basis reveals that the CPI was highest in July 2011 at 12.4 percent. However, in December 2011 it declined to single digit at 9.7percent. This trend allowed SBP to reduce the discount rate by 50bps and 150bps during the first half of FY2012. Although thereafter CPI increased steadily and reached 11.3 percent, SBP adopted a cautious approach by keeping the discount rate unchanged at 12 percent for the second half of the FY2012, considering the resurgence in inflationary pressures and emerging risks to macroeconomic stability.

### New Funds

During the year, 19 new funds were introduced (as given in table below), and 5 funds reached their maturity (all being Capital Protected Funds). A total of PKR 68 billion were added to the Total Net Assets through the new funds, out of which 95% were contributed by the Money Market and Fixed Income Funds. All of the new Fixed Income Funds, belong to its sub-category known as the Government Securities fund. This category of funds have a similar asset allocation and risk profile as the Money Market funds, except for longer duration.

	# of Funds	AUMs (PKR millions) (as of June 30, 2012)
Asset Allocation	3	1,031
Capital Protected	2	613
Equity	2	225
Fund of Funds	1	413
Income	5	43,325
Index Tracker	1	289
Islamic Capital Protected	1	443
Islamic Pension	1	126
Money Market	2	21,325
Pension	1	158
<b>Total</b>	<b>19</b>	<b>67,947</b>

### FY2012 for Mutual Funds Industry

By the end of the financial year there were 155 funds worth PKR 380.5 billion with 93% of the assets lying with the open-end funds. Within the open-end funds, 80% of the assets remain with Money Market and Fixed Income Funds (both conventional and Shariah-Compliant included). Assets Under Management of Money Market category and Fixed Income category have grown 87% and 84% respectively since last year.

2012 was the year that mutual fund investors got back into the market albeit in a more cautious manner than was the case before the market downturn. Total sales during the year were PKR 465 billion which was an increase of 98% since last year. Redemptions of around PKR 349 billion were observed resulting in a Net Sales of PKR 116 billion which in comparison with last year increased by 30%. Most of the sales and redemptions activity was observed in the Money Market category. Much of this activity was contributed by various banks and the AMC's parent organizations for short term cash management purposes.

Interest was observed in the Money Market, Income and Equity category for both the conventional and Shariah-compliant schemes. Investors who were invested in the hybrid funds such as Asset Allocation and Balanced continued to hold their investments and no major activity was seen in these categories. These hybrid funds are considered as long term investments as compared to the Money Market Funds which are used to park short term savings as they offer better returns than the banking deposits.

The returns of Money Market funds have been consistent over the years. Returns of around 11% have been





posted by almost all the funds in this category which have been better than the bank deposits. The Money Market funds may be redeemed within one working day, which makes it preferable for individuals and corporate investors who want to invest in low risk securities for a short period of time and benefit from the tax advantages. Serious investors, who have a long-term investment horizon, have shown interest in Equity funds, which however, have posted returns of around 10% this year but with increasing volumes and KSE-100 index surpassing its historical high, there is a huge opportunity of better returns in the future. Currently, 82% of the closed-end funds and 17% of open-end funds, a total of PKR 80 billion, have been invested in Equity funds. With the investor confidence increasing steadily, it is expected that the assets under management of equity funds will grow at a better increasing rate in the upcoming years.

The number of investors have been constant for some time. To increase the investor base, MUFAP has been engaged in various seminars and public awareness programs to educate/inform the masses about the benefits of investing in mutual funds. The awareness programs started with promoting the Money Market funds in the initial stage. The other mutual funds categories and voluntary pension schemes are also being worked upon in the next phase. MUFAP is also participating in SECP-ICM Investor Awareness programs for which various brochures and investment guides are being prepared in assistance with SECP and ICM. A 15% growth in the number of retail (individual) investors has already been observed in this financial year.

### Activities by MUFAP and its Committees

Committees comprising of individuals from MUFAP's member institutions are formed to tackle various industry issues. Some of the achievements of the Committees have been highlighted below:

#### Income Tax Proposals

The 'Audit, Accounts & Taxation Committee' along with the 'VPS Committee' prepared taxation proposals which were submitted to SECP for consideration. Some of the proposals which were incorporated in the Finance Bill, 2012 are:

- 1) For Mutual Funds:
  - a. Enhancement of caps of PKR 500,000 and 15% of a person's taxable income for the year, for availing tax credit on investment in new shares while reducing the holding period to 24 months from 36 months;
  - b. Arbitrage for banking institutions have been eliminated by enhancing the tax rate on dividends from Money Market Funds and Income Funds.
- 2) For Voluntary Pension Schemes:
  - a. Tax exemption on withdrawal from approved pension fund, on amount transferred from provident funds;
  - b. Exemption on payment representing monthly installments from an income payment plan invested out of the accumulated balance of an individual pension account.
- 3) For AMCs:
  - a. AMCs are exempted from FED.

These amendments along with other changes will contribute towards promoting savings for the longer term and post-retirement welfare. Many anomalies affecting the mutual funds and voluntary pension schemes have been removed and brighter sign is observed that the regulators are understanding the issues of the mutual funds industry and working towards achieving the best.

#### NBFC Regulations

MUFAP had been involved in extensive consultations with the regulators relating the NBFC Regulations. Amongst the various proposals, the significant amendments made were as follows:

- 1) Replacement of seed capital requirements with minimum fund size of Rs 100 million;
- 2) Enhancement of unit-holders' rights in case of any material change;
- 3) Suspension of redemption of units restricted to a maximum of 15 working days (except in an extra-ordinary situation);
- 4) Introduction of a detailed procedure for winding up of an open-end fund;
- 5) Registration of trustees of open-end mutual funds by the SECP;
- 6) Registration of distributors of mutual funds with MUFAP;

- 7) Exemption granted to index fund, fund of funds and capital protected fund from group company investment limits;
- 8) Reduction in limit of annual equity brokerage commission per broker from 30 percent to 15 percent; and
- 9) Restriction on mutual funds to subscribe to an issue underwritten, co-underwritten/sub-underwritten by group companies of its Asset Management Company.

During the year, SECP has also allowed investment in futures contracts on behalf of Collective Investment Schemes. These changes should encourage entrance of new players in the industry, increase competition, promote and develop new products and mutual fund industry.

#### Worker's Welfare Fund (WWF)

Despite working hard with the Government and Regulators, some issues still exist such as levy of WWF. Although the Worker's Welfare Fund (WWF) should not be imposed on the mutual funds, the anomaly still remains in the federal law. WWF is only applicable to establishments and mutual funds are not establishments but only a pass-through vehicle, where when the mutual funds distribute 90% or more of the profits to the unit holders, they are exempted from taxes. AMCs have taken up this issue in the courts, yet the decision is still pending. However, SECP has recently through its circular directed all AMCs to incorporate disclosures relating to the WWF levy in all its marketing and related documents till the decision is made. All Asset Management Companies are complying with the required disclosure and are expecting for a fair and favorable decision by the courts soon.

#### Debt Securities Trustee Regulations

During the year, SECP has approved the Debt Securities Trustee Regulations, 2012, which will provide guidance to the trustees of Debt Instruments (TFCs and Sukuks) in discharging their responsibilities under the Trust Deeds. The regulations empower the trustees to regularly monitor payment of profit/markup/interest to the debt security holders and redemption of the securities, compliance with the provisions of the Trust Deeds.

#### Management Fee Sharing

On request of MUFAP, a ban was placed on management fee sharing directly or indirectly with the investors.

#### Commodity Funds

SECP is expected to allow a new category of mutual funds that would invest primarily in commodities such as Gold.

#### Exchange Traded Funds

The ETF Rules were notified by the SECP during the year. Although there are no ETFs yet in the industry, a few funds may be launched in the upcoming year. ETF is a very popular and successful investment avenue globally. ETFs are funds with transparent portfolios which provides exposures to a variety to markets/indices (both local or international).

#### Conclusion

Despite the slow turnaround of the asset management industry, it is headed in the right direction. The industry has learned a lot from the pitfalls it has been into. The industry has built itself with high standards of ethics and professionalism, maturity and consolidation it has observed over the recent years. There is now need to expand the investor base and here the Regulator and Government's help is required to facilitate asset managers to promote, educate and encourage investors to save. I certainly am looking into a better year ahead.

