COMMITTEE REPORTS

ACCOUNTS AND TAXATION COMMITTEE

(8 meetings held in the period October 1, 2012 – June 30, 2013)

Member	Meetings Attended	Member	Meetings Attended
Imran Azim *(Chairman)*	8 of 8	Mashmooma Z. Majeed	8 of 8
M. Habib ur Rahman *(Vice-Chairman)*	8 of 8	Muhammad Murtaza Ali	2 of 8
Amir Mobin	6 of 8	Noman Soomro	6 of 8
Jawad Ahmed	2 of 2*	Umair Ahmed	3 of 7**
Maleeha Bangash	5 of 8	Zainab (Abubakar) Siddiqui	6 of 8

*(*Appointed Member from April 8, 2013)*

*(**Appointed Member from November 16, 2012)*

TERMS OF REFERENCE

- Taking up any matter relating to accounts/audit with Auditors, ICAP and SECP or any other authority as and when they arise;
- Making proposals for Federal or Provincial Budgets;
- Drafting of a long term tax policy of MUFAP;
- Examining and resolving any tax related issues; and
- Any other matter connected with Audit, Accounts and Taxation;

ACTIVITIES' REPORT

1. Workers Welfare Fund (WWF)

In March 2013, a three member bench of the Honourable Sindh High Court reversed the decision of a single member bench of Honourable Lahore High Court which had held that the amendment in Workers' Welfare Fund Ordinance brought in through Finance Act, 2006 and 2008 (Money Bills) was unlawful and unconstitutional for the reason that they were made through money bills. The three member bench of the Honourable Sindh High Court held that WWF is a tax and consequently the amendments through money bills do not suffer from any constitutional or legal infirmity.

The Accounts and Taxation Committee deliberated and was of the view that the ground on which mutual funds and pension funds have filed the case in Honourable Sindh High Court was that the funds are not entities and thereby are not subject to WWF and as such the above decision had no implication on the case. Honourable Sindh High Court has already granted stay to mutual funds and pension funds on the basis of the constitutional petition that has remained intact. MUFAP is making all efforts to early resolution of the matter. Messrs Haidermota and Co. are representing mutual funds and pension funds in this case.

2. Punjab Revenue Authority (PRA)

A few members received letters from PRA for registration with them. The Accounts and Taxation Committee discussed the matter. It was noted that both the laws, Sindh Sales Tax on Services Act 2011 by Sindh and Punjab Sales Tax on Services Act 2012 by Punjab had different wordings which was leading to double taxation. Sindh is charging tax on origin of services while Punjab is charging tax on receipt of services. This was a matter which can only be dealt at the Government level and the Committee recommended that MUFAP with approval of Board, write to SECP to take up the matter with the two provincial Governments to determine a formula wherein all provinces get their due share without any double taxation to the unit holder.

3. Accounting treatment of Element of Income

The Commission had shared with MUFAP for comments, a concept paper made by ICAP on the accounting treatment of Element of Income, which stated that Element should be recognized in Distribution Statement and not in the Profit and Loss Statement. The Committee reviewed the same and was of the opinion that under the current accounting treatment, the profit and loss account depicts the profit of the mutual fund, ninety-per cent of which has to be distributed to investors so that the mutual fund remains exempt from income tax. If the element of income and capital gains is to be recognized in the Distribution Statement, Profit and Loss Account would no longer depict the distributable profit. Under the present tax law it was not advisable to change the accounting treatment.

4. Federal Budget Proposals for the year 2013-2014

The Committee prepared draft taxation proposals for the fiscal year 2013-14 relating to development of retail segment of mutual funds, voluntary pension schemes and debt securities, that were sent to the SECP for consideration and onwards submission to the FBR. Following proposals were submitted to SECP for onward submission to FBR:

i) Income Tax Proposals relating to Mutual Funds:

a. Insertion of new Section 65F in the Income Tax Ordinance, 2001

In order to expand retail base, a tax credit equivalent to fifteen percent should be given to asset management company on incurring expenditure on establishment, operational and administrative expenses of branch offices or sales offices outside of Karachi, Lahore, Islamabad and Rawalpindi, with maximum carry forward of the same for two tax years.

b. Insertion of new Clause 2A of Part II of the Second Schedule to the Income Tax Ordinance, 2001

Any income from the sale of collective investment schemes (mutual funds) to individuals earned by Distribution Company should be charged to tax at the rate of fifteen percent of such income.

c. Insertion of new proviso to Clause 6 of the Seventh Schedule to the Income Tax Ordinance

Any income from the sale of collective investment schemes (mutual funds) to individuals earned by a Banking company should be charged to tax at the rate of twenty percent of such income.

ii) Income Tax Proposals relating to Retirement Schemes:

a. Amendment in Section 156B of Income Tax Ordinance, 2001

Like other taxes, withholding tax deduction on withdrawal of accumulated sum from VPS of an amount that represents transfer from provident fund should also be exempt; as the same is already exempt under clause 23C of Part I of Second Schedule.

b. Amendment in Section 156B of Income Tax Ordinance, 2001

Withholding tax deduction of monthly installments paid from Income Payment Plan, the duration of which exceeds ten years, should be exempt as the same is already exempt under clause 23B of Part I of Second Schedule.

c. Amendment in Section 63 of Income Tax Ordinance, 2001

The facility of additional tax credit under VPS, if investment is made after forty years of age, should be extended for a period of five more years, as presently it is only up to June 30, 2016.

iii) Others:

a. Amendment in Clause 6 of Seventh Schedule

Taxation for dividends received by Banks from their asset management companies should be the same as that of dividends received by them from other companies.

b. Amendment in Proviso to Clause 6 of Seventh Schedule to the Income Tax Ordinance, 2001

Taxation rate should be frozen at 25% for two years on Dividends received by Banks from investment in money market and income fund units.

Furthermore, current tax treatment should not be changed regarding dividends received by companies other than banks from investment in money market and income fund units.

c. Amendment in Division I of Part I of the First Schedule for Rates of Taxes for Salaried Persons

Amendment in Division 1 of Part 1 of the First Schedule for Rates of Taxes as applicable on salaried persons to remove the anomaly in the tax rates of salaried class in slab for salaries above Rs. 2.5 million, created by Finance Act, 2012

Just before the budget, news appeared in Business Recorder that the Government was considering taxing dividend income of companies from money market and income categories of mutual funds at the corporate rate of tax, instead of 10%. The matter was immediately discussed with SECP so that they may raise the issue with FBR. Due to SECP's active efforts on the matter no such amendment was introduced. The Government further introduced that the tax rate on banks' income from money market and income funds is fixed at 25% from fiscal year 2014 onwards. The ultimate result is that company's dividend income from mutual funds will be taxed at normal dividend rate and banks' dividend income from money market and income categories of mutual funds shall be taxed at 25%.

The Finance Bill announced in the Budget speech contained certain provisions that were damaging to mutual funds and pension funds, while it was not generating tax revenue to Government. These were:

- Tax credit under Section 61 (Donations), Section 62 (investment in new issues, mutual funds and life assurance) and section 63 (contribution to approved pension schemes) to be allowed by Commissioner of Income Tax at assessment stage instead of adjustment by employers salaries payment stage.
- Mutual Funds income from margin financing was subjected to withholding tax.

Both these proposals involved excess tax collection by FBR and then refund. There was no net collection of taxes. The Government decided to remove these provisions from the Finance Act that was passed by the National Assembly.

The Finance Bill also imposed Federal Excise Duty (FED) on asset management services. The Committee also represented to FBR through SECP that since Provincial Governments were already collecting General Sales Tax on asset management services, imposing of FED amounted to double taxation. Further such taxes will discourage savings in the country. The Committee also learnt that the Sindh Assembly also passed a resolution against imposition of FED calling it an unconstitutional provision by Federation as taxes on services is a provincial subject. Despite MUFAP and SECP's representation and protests by Sindh Assembly, the Federal Government continued with the proposal of imposing FED on asset management services. The amendment was approved by the National Assembly. Later during August and September 2013, notices were sent to asset management companies for collection of FED. After consulting with MUFAP legal counsel, it was decided to file a petition in the Honourable Sindh High Court on constitutional grounds. The petition has since been filed and the Court has granted stay order. Mr. Rashid Anwar of A. K. Brohi and Co. is representing MUFAP in the Honourable Sindh High Court.

5. Provincial (Sindh) Budget Proposals for the year 2013-2014

The Committee prepared draft taxation proposals relating to Sindh Sales Tax on Services for the fiscal year 2013-14 for the consideration of Sindh Revenue Board (SRB). It was recommended that SRB should consider to waive/ reduce sales tax on asset management services as this tax was passed on tax to unit holders. Mutual funds are savings tools and collective investment vehicles that direct savings to capital markets for productive uses. No such tax is levied on other savings products. Particular emphasis was laid on VPS as no such tax exists for other retirement/ occupational savings schemes and VPS has retirement savings of general public and levying tax on the same is not justified.

MUFAP'S CODES, ETHICS & CORPORATE GOVERNANCE COMMITTEE

(1 meeting held in the period October 1, 2012 – June 30, 2013)

Member	Meetings Attended	Member	Meetings Attended
Imran Motiwala *(Chairman)*	1 of 1	Mashmooma Z. Majeed	1 of 1
Amer Maqbool *(Vice-Chairman)*	1 of 1	Muhammad Asim	1 of 1
Ahmad Nouman	1 of 1	Muhammad Yaqoob Sultan	0 of 1
Ahmed Ateeq	0 of 1	Sadaf Adnan	0 of 1
Aly Osman	1 of 1	Salman Shakoor	1 of 1
Hamad Aslam	0 of 1	Shahzad Jawahar	0 of 1
Jawad Ahmed	1 of 1	Zainab (Abubakar) Siddiqui	1 of 1

ACTIVITIES' REPORT

1. Compliance of the RSPs with the management fee directive issued by the Commission banning fee sharing with the unit holders:

The Committee discussed and reviewed the Code of Qualification and Conduct for Registered Service Providers in detail. It was brought to the attention of the Board that some distributors might be colluding with some institutional investors for indirect management fee sharing. The Board refered this matter to the Committee. For the same, the Committee analyzed the Indian Model of advisory fee for compensating distributors to see if it was advisable to adopt the same here but concluded that this model hasn't worked well for India. India has abolished front-end load and distributors charge a flat fee per investment application to AMCs. Moreover, they charge advisory fee from clients. The Committee recommended that MUFAP should keep charge of the non-compliances and report to the Commission accordingly.

No other activity was taken up by the Committee.

TERMS OF REFERENCE

- Developing MUFAP codes for members and service providers
- At least Annual review of all MUFAP's Codes and Guidelines (this includes periodic review and ad hoc review of MUFAP's Code of Qualification and Conduct for Registered Service Providers);
- Ensuring Implementation of Codes, including action against violators or reporting to SECP;
- Annual Review of Sales Agents Training Manual (being operated by ICM)
- Drafting guidelines for MUFAP Board on Governance vis-a-vis investee company;
- Drafting proposals as to MUFAPs role in protecting investors' interest;
- Keeping track of practices in other jurisdictions & circulating articles on the subject;

PRICING POLICY, DEVELOPMENT & PROMOTION OF DEBT SECURITIES COMMITTEE

(5 meetings held in the period October 1, 2012 – June 30, 2013)

Member	Meetings Attended	Member	Meetings Attended
Hina Ghazanfar *(Chairperson)*	5 of 5	Muhammad Ali	4 of 5
Yasir Qadri *(Vice-Chairman)*	4 of 5	Muhammad Asad	2 of 5
Amir Khan	4 of 5	Muhammad Imran	4 of 5
Jawad Ahmed	1 of 1*	Zainab Abubakar	4 of 5
M. Habib Ur Rahman	3 of 5	Zulfiqar Azam	4 of 5
Mashmooma Z. Majeed	5 of 5		

*(*Member since April 8, 2013)*

TERMS OF REFERENCE

- To review pricing policy, identify shortcomings and suggest revisions;
- To activate trading of debt securities at the floor of the stock exchange;
- To activate trading of privately placed debt securities at the floor of the stock exchange;
- Valuation of Debt Instruments including Ijarah Sukuks;
- To incorporate provisions for debt securities in the listing regulations as submitted by KSE (on recommendations of MUFAP) to SECP, with or without modifications; and
- To safeguard investor interest from non-performing companies.

ACTIVITIES' REPORT

1. Circular # 33 of 2012 (Replacement of Annexure I and II of Circular No. 1 of 2009 and repealing of Circular No. 6 of 2009 and Circular No. 3 of 2010):

The Commission issued Circular 33 of 2012 which was the replacement of Circular 1 of 2009 and repealing Circular 6 of 2009 and Circular 3 of 2010. The Committee met to discuss the circular in detail and review the MUFAP's internal practice statement pertaining to reclassification of non performing securities as performing which was made in light of amendments brought about by Circular No. 33 of 2012. It was highlighted that the Commission removed the 15 day grace period to zero due to a misinterpretation of MUFAP's recommendation which created volatility in TFC pricing. The Committee proposed with the approval of the Board MUFAP that the 15 days grace period be restored which was accepted by the SECP.

2. Bond Pricing Agency (BPA)

The Committee reviewed the brief received from the Bond Pricing Agency and noted that the price being quoted by BPA for the mutual funds was too high. The price was proposed to be 0.0075% per fund per month (approx working out to 9 bps per fund per year), which amounts to Rs. 1.4 mn per month (the monthly operational expenses of BPA) which the BPA intended to fully charge to the mutual funds. The Committee recommended that mutual funds should only be charged BPA costs in proportion to its TFC holdings in TFC market, in performing debt securities only. The same was shared with the Commission, after approval by the Board, also requesting them to study the detailed methodology of BPA.

3. Development of Bond Market

The Committee took up the matter of the development of the Bond Market in its mandate and invited Mr. Muhammad Sohail (CEO, Topline Securities and Director and Chairman of Market Development & Products Committee at Karachi Stock Exchange) for his views and feedback. Mr. Sohail pointed out that activity in bond market is very thin and can be spurred through market making. Various problems and opportunities of doing that were discussed in light of international practices. It was discussed that market making regulations exist for equity market and regulation for debt securities may be developed on similar lines. Exchange shares fee with market makers. Indian exchanges have done market making on similar lines even paying out of its pocket to create market activity and boost trading. Credit risk can be taken care of by dealing in sound TFCs only. Reward system for trading may also be designed. All debt securities listed on one exchange should be deemed to be listed on all exchanges, to facilitate trading. Banks and Mutual Funds can then be involved in market making to increase activity and eventually develop the bond market.

4. Dealing with issues in valuation of debt securities

The Committee meet to discuss the case of Maple Leaf Cement Sukuk, which had been classified twice as non-performing due to its non-payment of the coupons in December 2009 and then in September 2011 in light of the newly announced Circular 33 of 2012. Due to some difference of opinion in the interpretation of the circular due to ambiguity in the wordings, the matter was referred to the Commission for clarification.

5. Valuation of Ijarah Sukuks

The Committee continued to monitor the PKISRV rates released by FMA/Reuters to review its volatility for the purpose of considering it to mark-to-market Ijarah Sukuks in calculating their daily NAVs. The Committee noted that while the volatility had reduced, it still remained. After various meetings, the Committee decided that all the members should provide quotes of every Ijarah to the brokers. The Committee noted that PKISRV still has not been approved by the SBP for Banks as a result of which the Banks are not actively participating in providing quotes and till the time Banks actively participate in the same, volatility will persist in it and decided that MUFAP should write to SECP to discuss the matter with SBP to approve the same for Banks so that all the banks should start actively providing the quotes. This activity would capture complete market information and avoid unnecessary volatility. Other methods for mark-to-market of Ijarah were tested like, using a valuation model, e-bond prices but none seemed feasible and PKISRV rates were the most relevant to Mark to Market the instruments A few members were of the opinion that it will be in the best interest of unit holders that the practice of valuing Ijarah Sukuks at par or at cost is continued till SBP approves PKISRV and all volatility is smoothened out. The Committee also invited Mr. Nasim Beg to solicit his views and guidance on the matter. The Board reviewed the matter and decided to recommend to the SECP of using of "PKISRV" quoted on Reuters/FMAP as the relevant price to "Mark to Market" the Ijarah Sukuks to bring consistency in the industry and standardize the price at which the Ijarah Sukuks are marked to market. The SECP notified the same in September 2013.

PUBLIC AWARENESS & EDUCATION COMMITTEE
(6 meetings held in the period October 1, 2012 – June 30, 2013)

Member	Meetings Attended	Member	Meetings Attended
Mir Muhammad Ali *(Chairman)*	6 of 6	Mashmooma Z. Majeed	6 of 6
Farid Ahmed Khan *(Vice-Chairman)*	2 of 6	Noman Soomro	4 of 6
Abbas Sajjad	5 of 6	Sahar Khalid	4 of 6
Ali Tariq	4 of 6	Shafaq Khurram	1 of 6
Ana Mateen	1 of 6	Syed Akbar Ali	3 of 6
Assad Hameed Khan	1 of 6	Umber T. Ansari	4 of 5**
Jawad Ahmed	2 of 2*	Yasir Qadri	4 of 6
Khalid Husain	2 of 6	Zainab (Abubakar) Siddiqui	4 of 6
Maleeha Mimi Bangash	6 of 6		

*(*Member since April 8, 2013)*

*(**Member since November 2, 2012)*

TERMS OF REFERENCE

- To draw up and conduct public awareness campaigns regarding mutual funds and voluntary pension schemes;
- To promote goodwill between the industry and public; and
- To organize workshops/ seminars for investors/ industry personnel.
- Participation/ conducting in the SECP-ICM Investor Awareness Program
- To draw support from SECP to arrange specific awareness programs for mutual funds and pension schemes
- Development and Periodic/ad-hoc review of investor education brochures and presentations of MUFAP (at least Annual)

ACTIVITIES' REPORT

1. Investor Awareness and Education Programs:

The Committee worked on developing a comprehensive three year Public Awareness Program to reach the retail investors with a bigger impact. The plan included a marketing strategy mix of advertising, social media and seminars/investor awareness sessions. It was recommended to initiate the product with a market research survey by one of the top research companies to enable the most appropriate strategy to target the relevant target audience. This three year comprehensive plan was to be implemented in collaboration with Trustees and SECP. The overall funding of PKR 100 million was proposed over three years.

A sub-committee was set up to develop an investor guide. The investor guides were drafted for both mutual funds and pension funds. Another sub-Committee was constituted to develop a small one month Roadshow/BTL activity. The activity was proposed at office buildings and shopping malls to target the working class and families about savings through mutual funds.

The plans were presented to the Board by the Committee but could not materialize as the budgets were not approved.

TECHNICAL COMMITTEE - MUTUAL FUNDS

(4 meetings held in the period October 1, 2012 – June 30, 2013)

Member	Meetings Attended	Member	Meetings Attended
Dr. Amjad Waheed *(Chairman)*	4 of 4	Mohammad Shoaib	3 of 4
Babar Ali Lakhani *(Vice-Chairman)*	2 of 4	Noman Qurban	2 of 4
Adnan Siddiqui	2 of 4	Shakeel Musani	1 of 4
Farid Ahmed Khan	3 of 4	Sohail Qadri	3 of 4
Mashmooma Z. Majeed	4 of 4	Yasir Qadri	4 of 4
Mir Adil Rashid	2 of 4	Zainab (Abubakar) Siddiqui	4 of 4
Mir Muhammad Ali	2 of 4		

ACTIVITIES' REPORT

1. Employees Provident Fund:

The Committee recommended some amendments in the Investment in Listed Securities Rules, 1996 which were forwarded to the Commission.

2. Distributors of Mutual Funds

To remove any conflicts of interest and also the possibility of misuse of SECP directive for direct and indirect management fee sharing, the Committee made a few recommendations to the Board for consideration which included that the distributors should be compensated by the institutional investors for distribution/ investment advisory services instead of the AMCs sharing management fee with them. It was also discussed that a maximum slab for management fee sharing with the Distributors should be introduced for corporate and retail investments. These recommendations were not approved by the Board.

3. Development of Retail Segment

The Committee prepared a presentation and shared it with the Board for the development of the retail investor base. It was recommendd that spreads were too low for asset management companies to target the retail market. Comparative spreads of life insurance and the banking industry were shared. Currently, there is lack of awareness about mutual fund products among individuals in Pakistan. The Committee proposed some solutions such as minimum (standard) fee and load structure on mutual funds for increasing the spreads to enable more spending in developing the retail segment. The same were not approved by the Board.

4. Merger of Open-End Funds

The Committee discussed the issues relating to the merger of open-end funds. After looking into various global practices mainly the Indian legislation, the Committee came up with some recommendations and amendments in SECP's Circular 20 of 2009 which were sent to the Commission for consideration.

5. Enhancing Sector limits consequent to introduction of free float index

The Committee discussed that according to NBFC Regulations, an equity funds can invest up to 30% or index weight % of total assets of the Collective Investment Scheme, whichever is higher, subject to maximum of 35%, in any one sector as per the classification of stock exchange. In the Oil & Gas sector, however, as KSE-100 index has moved to free float methodology, the limit has reduced to 30% as implied by revised reduced index weights (from 37% to 29.6%). This was a matter of concern as the Oil and Gas sector is one of the most profitable sectors and where earlier 35% allocation was allowed to funds it was now reduced due to change in index weight to 30%. The Committee recommended to the Board that MUFAP should write to the Commission requesting it to enhance exposure limit to 40% or index weight % of total net assets of the Collective Investment Scheme, whichever is higher, subject to maximum of 45%. The same was sent and is currently pending at SECP's end.

TERMS OF REFERENCE

- To review Acts, Ordinances, Rules and Regulations, Circulars pertaining to mutual funds on an ongoing basis and making recommendations to the SECP;
- Periodic and ad hoc review of standardized trust deed and offering document (at least Annual)
- To research on investment products in international markets
- Drafting regulations for new product development
- To deal with issues related to Shariah advisors and Shariah advisory Boards

TECHNICAL COMMITTEE – VPS

(4 meetings held in the period October 1, 2012 – June 30, 2013)

Member	Meetings Attended	Member	Meetings Attended
Rashid Mansur *(Chairman)*	4 of 4	Mir Muhammad Ali	3 of 4
Mohammad Shoaib *(Vice-Chairman)*	3 of 4	Shahid Motiwala	2 of 4
Ali Tariq	2 of 4	Sohail Qadri	3 of 4
Jawad Ahmed	2 of 2*	Tanweer Haral	4 of 4
M. Abdul Samad	4 of 4	Wasim Akram	1 of 4
M. Habib-ur-Rahman	3 of 4	Zainab (Abubakar) Siddiqui	2 of 4
Mashmooma Z. Majeed	4 of 4		

*(*Member since April 8, 2013)*

TERMS OF REFERENCE

- To review Acts, Ordinances, Rules and Regulations, Circulars pertaining to voluntary pension schemes on an ongoing basis and making recommendations to the SECP;
- To research on investment products in international markets and urge Regulator to draw up regulations relating to them.
- To host a website for VPS to enhance awareness
- Run public awareness print campaigns for VPS in coordination with Public Awareness Committee
- To review Acts, Ordinances, Rules and Regulations, Circulars pertaining to existing occupational savings schemes an ongoing basis and making recommendations to the SECP.

ACTIVITIES' REPORT

1. Circular 36 of 2009:

The Committee had proposed changes in the investment policy of the VPS as mentioned in SECP's Circular 26 or 2009, which the Commission accepted and notified.

2. VPS Website

For the promotion of VPS, the Committee has been working on a website with detailed information on VPS including the guidelines, performance, investments, etc. The website is completed and ready to go live after final review.

3. Presentation on VPS to SECP Employees

MUFAP held an investor awareness session for the SECP employees on VPS in Islamabad. The presentation was delivered by the CEO MUFAP while representatives of all VPS Managers were present to further guide the employees. The presentation included information from the basics to the complexities of tax advantages and performance of all the pension funds. The presentation was much appreciated by the employees and the management.

4. Presentation on VPS to Members of OICCI

MUFAP held an investor awareness session on VPS for the members of Overseas Investors Chamber of Commerce & Industry (OICCI). The presentation was delivered by the CEO MUFAP while representatives of all VPS Managers were present to further guide the participants. The presentation included information from the basics to the complexities of tax advantages and performance of all the pension funds. Such activities are being planned with other associations and organizations.

REVIEW OF NBF REFORM COMMITTEE REPORT (AD-HOC) COMMITTEE

(3 meetings held in the period October 1, 2012 – June 30, 2013)

Member	Meetings Attended	Member	Meetings Attended
M. Habib-ur-Rahman *(Chairman)*	3 of 3	Shamshad Nabi	3 of 3
Imran Azim	3 of 3	Yasir Qadri	1 of 3
Mashmooma Z. Majeed	3 of 3	Zainab Abubakar *(Secretary)*	3 of 3
Muhammad Asad	3 of 3	Saqib Saleem *(in place of Yasir Qadri)*	2 of 3
Noman Soomro	2 of 3		

ACTIVITIES' REPORT

Background

SECP had constituted a 16-member committee of twelve leading market experts and four senior SECP officials to suggest reforms for promotion and growth of a sustainable Non-bank Financial (NBF) sector. The market experts included Dr. Amjad Waheed, Mr. Shahid Ghaffar and Mr. Nasim Beg from the mutual fund industry. The draft report was published in March 2013 for public comments. The report identified the following key issues that must be addressed to support the growth of mutual fund industry:

- Limited retail investor base
- Limited investor awareness
- Lack of branch network/ limited distribution outreach
- Focus on institutional clients
- Cost associated with targeting retail investors
- High expense ratio
- Other factors such as high return/low risk offered by NSS with no KYC requirements, implicit safety of capital in NSS and bank deposits and Presumptive Tax Regime for NSS and bank deposits holders
- Underdeveloped debt capital market
- Majority bank-owned AMCs
- Limited fund management activities
- No specific skill set requirements for Fund managers
- High capital requirements
- Fair calculation of NAV
- Governance conflict
- Misleading performance presentation (i.e. focus of financial reports on profits, capital gains and dividends instead of growth in NAV and performance relative to benchmark)

After reviewing the prevailing practices in other jurisdictions, the Committee constituted by SECP had made the following recommendations:

- Incentives for AMCs to target retail investors
- Development of own branch network by AMCs
- Distribution of mutual funds through stock exchanges
- Distribution of mutual funds through other channels
- Operational flexibility to encourage product innovation
- Offer multiple classes of units for retail and institutional investors with different level of management fee
- Introduction of total expense ratio.

The Ad-hoc Committee held three meetings to discuss the report and also invited Mr. Mohammad Shoaib, Dr. Amjad Waheed, Mr. Nasim Beg and Mr. Shahid Ghaffar, to discuss their views. MUFAP had also invited comments from all members on the report which were also discussed in the Committee.

The Committee appreciated the efforts put in by the Commission & its Committee for framing up a detailed, meaningful and comprehensive road map which well presents the headway of the NBF Sector towards much needed reforms. MUFAP's Ad hoc Committee noted that the resolution of the macro level issues highlighted in Chapter 6 of the Report would need to be taken up with the Government to resolve. The Government should be receptive to proposals

TERMS OF REFERENCE

- Constituted by Board on March 19, 2013, to review and formulate comments on the NBF Reform Committee Report issued by the SECP in March 2013.

that would improve the tax to GDP and savings to GDP ratios, cutting down budget deficit and invigorate the economy.

The comments on the Report were as under:

PART – I NBF Sector - Background and Issues

Section 2.4(i)(f): Issues (Other factors): This section states that other likely reasons for limited retail investor participation in mutual funds are high return/ low risk offered by NSS, no KYC requirement by NSS, implicit safety of capital in NSS and Presumptive Tax Regime for NSS holders.

MUFAP has been communicating to the SECP time and again that NSS is not only hampering the development of mutual fund industry but also are a major threat to the progress of entire capital markets of Pakistan. The high rates of return on NSS are slowing down private sector growth as the high interest rates become a barrier for business and industrial investment and expansion, thus slowing down economic growth rate of the country. MUFAP had suggested that NSS should be phased out/ discontinued for institutional investors as it had been done in the past. For individuals, Behbood and Pensioners scheme, regular income schemes are important, however some limits to investments should be introduced for all schemes as is available in Behbood Schemes. Additionally, Know Your Client (KYC) requirements should also be made applicable to NSS as well. This will help reduce money laundering in the real sense and improve transparency and documentation of the economy. It is pertinent to note that prize bonds which are very popular in the country are bearer and no KYC requirements are applicable on them.

Section 2.4(vi): High Capital Requirements: While this section recognizes that the equity requirement of PKR 200 million for an asset management company is high and acts as a strong barrier for entry, the way forward section doesn't recommend any changes to it. MUFAP recommended that for asset management services also, capital requirements should be divided like the same is being done for the investment finance services and slabs should be there for each type/category of fund being introduced.

PART – III - Way Forward

Section 1.1(b): Investment Advisor vis-à-vis brokerage activities: To avoid the conflict of interest and excessive churning in the portfolio MUFAP recommended that following disclosure requirements should be mandatory: It must be disclosed to the investor, as to how much total brokerage commission has been paid and advisory fee have been charged on the portfolio of the investor. Total expense ratio of the portfolio must be disclosed to the client at least on a quarterly basis. Furthermore, 'Fit and Proper Criteria' requirements for both the eligible entities and the fund managers must be met before grant of IAS license.

Section 2.1(a)(iii): Reduction in SECP fee: The condition for availing incentive of reduction in SECP fee on building up of retail base, should be altered as, “at least 1,000 investors and more than 50% of their ownership is held by individual/ household matter and retirement funds (in terms of funds' net assets)”. The reason is that retirement funds are held on behalf of individual investors and therefore should be treated as retail investors.

Section 2.1(f): Multiple classes of units: MUFAP does not agree with the proposed system of multiple classes of units on the basis of amount of investment. The Committee recommended that the fee should be uniform across the Board and if at all there has to differentiation in fee it should be on the basis of holding period rather than amount of investment, as that was discriminatory to small investors.

Section 2.1(g): Introduction of expense ratio: MUFAP agreed with the fixing of the expense ratio. However, government levy on funds such as General Sales Tax, SECP annual fee and SECP registration fee, brokerage, securities and transaction costs, provision against debt securities and legal fee incurred to protect fund property should be excluded from overall expense ratios. In addition, cost of the Board of Trustees (if such Board is created), should not be included in the calculation of the expense ratio.

MUFAP further proposed that Commission should only cap the expense ratio, and no further capping on management fee should be implemented. Commission may consider reintroducing performance fee (for outperforming the benchmark). Performance fee should be outside of expense ratio.

Section 2.7: Independent Board of Trustees: MUFAP suggested that Board of Trustees should not be separate for every mutual fund as stated in the Report rather there should be one Board of Trustees for one AMC. MUFAP agreed with the concept of independent Board of Trustee but highlighted that details needs to discussed, as to number, cap on fee to be paid to trustee and fit and proper criteria.

Section 2.8: Series of capital protected funds: MUFAP recommend that Fixed Return Funds should also be included in this section.

Section 2.10: Development of Debt Market:
Historically the "Listing Regulations" were made with a view to cover the requirements of "equity securities" and investors in equity securities. If bond market is to be developed, the stock exchanges need to amend listing regulations to cover provisions for bonds, TFC and sukuks. The provisions should cover among things the following:

(ii) Availability of up-to-date Trust Deed and other legal documents on the web-site of the issuers and the Trustee;
(iii) Availability of quarterly, half yearly and yearly accounts on the web-site of issuers and the Trustee and supply to investors on request;
(iv) Payments of mark-up and principal instalments;
(v) Provision regarding sensitive information;
(vi) Restructuring, default and similar matters;
(vii) Mandatory on issuers that in the event of non-performance they would post monthly report on the web-site about the financial position of the Company and simultaneously provide the information to the stock exchange.

There is a need to review the legal system to simplify the procedure so that legal recourse is simple. Quite often the large banks are not interested in pursuing legal actions as they prevail on the issuers to settle their dues. Small investors are left high and dry. It is proposed that where the issuer has not performed, the stock exchange, SECP and the SBP should intervene and be pro-active to ensure that the management is genuinely making efforts to resolve the problems facing the Company. Where such is not the case and the non-performance is due to financial irregularity, legal action must be taken jointly by the investors

In some jurisdictions, a suspense account is created in which a certain portion of the initial float goes into and any interest earned on that account remains there till the maturity of the TFC when it is paid to the investors. This account creates a reserve with the trustee in case of a default. Similar provision for legal expenses should be created by the Trustee when the Issuer floats an issue and the same should be invested to generate returns.

Moreover, in case if banks are not invested in a particular debt security in case of default by any issuer, Credit Information Bureau Report (CIB Report) is not updated and the default does not show in the CIB report. This should not be the case and NBFC sector should also be allowed to report defaults to the SBP to be included in the CIB Report.

Section 3: REITs: REIT Management Companies should not be required to indulge into property management as current regulations require. This is not their expertise. AMCs invest in companies that are managed by others. We recommend that AMCs as REIT managers should be allowed to have a portfolio of properties without requiring them to be property managers.

General Comments:

1. MUFAP stated that all changes proposed in the Report for mutual funds should also apply to voluntary pension schemes, including the ban on management fee sharing and the benefits being offered to asset management companies to develop the retail investor base including the charging of marketing and accounting related expenses to the fund.

2. The Trustee fee charged to the fund should be flat fee applicable on the assets under management.

3. MUFAP observed that the Report did not cover retirement schemes, both VPS and Occupational Savings schemes (Provident, Pension and Gratuity). Many countries have carried out pension reforms that have enabled them to bring improvement in the savings rate and develop the capital markets. In Pakistan the

responsibility of initiating the reform was assigned to the Commission by amending the SECP Act. MUFAP Committee was of the view that the Commission would need the full support and commitment of the Government to undertake this task. MUFAP Committee identified that the reform would need to cover the following areas:

- There is a dire need to create one regulatory regime under the Securities and Exchange Commission of Pakistan for all retirement schemes for effective regulation. At present these are scattered.
- There is also a need to ensure that all schemes offered by the Government are funded, so that pension liabilities are paid out of fund so created and to prevent the future generation of Pakistan to be burdened with heavy taxes due to ballooning unfunded pension payments.
- To ensure that those in self employed category also save for retirement by joining VPS or similar schemes by offering them tax incentives. At present due to presumptive tax regime, no tax incentive exists for such individuals.

4. World over mutual funds are regulated under securities law and not the company law. There is dire need to address the legal regulatory framework as well and we request the Commission to deliberate on the same. Many fundamental issues can be resolved if there is a separate regulatory regime for unit trust schemes including new standards for accounting, reporting, disclosure, which does not fall under the umbrella of company law.

MUFAP appreciated the time and effort put in by the Committee to bring forward this report and assured full support in getting the same implemented.

INTERPRETATION OF THE REGULATION 65 OF NBFC & NE REGULATIONS, 2008 (AD-HOC) COMMITTEE

(5 meetings held in the period October 1, 2012 – June 30, 2013)

Member	Meetings Attended	Member	Meetings Attended
Rashid Mansur *(Chairman)*	5 of 5	Mir Muhammad Ali	2 of 5
Imran Motiwala	5 of 5	Nihal Cassim	5 of 5
Mashmooma Z. Majeed	5 of 5	Zainab Abubakar *(Secretary)*	5 of 5
Mir Adil Rashid	4 of 5		

ACTIVITIES' REPORT

The Ad-hoc Committee held five meetings towards resolving the confusions relating to legal interpretation of Regulation 65 and other operational matters pertaining to holding of meeting of certificate holders/ shareholders, passing of special resolutions, circulation of statement of material facts etc. In three meetings all the closed-end fund managers were invited to discuss their view points. SECP on November 5, 2012, notified draft amendments to Regulation 65, changing the regulation drastically, so the Committee also sought a legal opinion to address legal implications created by the proposed amendments for the various types of closed-end funds in the industry (i.e. Closed End Funds where Management Rights were purchased by the AMCs in the Privatization process, Closed End Funds which have been constituted under the Company Structure and those which have been constituted under the Trust Structure). These issues along with detailed comments on the proposed draft amendments were shared with the SECP in a meeting held with the Chairman SECP and his team in Islamabad, which they agreed to consider and look into.

TERMS OF REFERENCE

- Constituted by Board on October 1, 2013, to deal with the problems being faced by Closed-end Fund Managers in the interpretation and implementation for the Regulation 65 of NBFC & NE Regulations, 2008.