Chairman Review

Mr. Farid Ahmed Khan, CFA

Chairman, Mutual Funds Association of Pakistan

The current year proved yet another challenging and eventful year for the mutual funds industry. With the uncertainty in the economy, increase in the interest rates and volatility in the equity markets, the investors remained vary and the industry witnessed significant shift from equity funds to money market funds. Industry size went down by 11.45% during the year despite the fact that around 56 thousand new accounts were opened in open end funds (excluding the accounts pertaining to conversion of 2 closed-end funds into open end funds) and the number of AMC branches increased by 27.

	2018-19	2017-18	Change (%)
Mutual Funds AUMs (Rs bn)	514.07	583.61	-12%
Pension Fund AUMs (Rs bn)	25.89	26.13	1%
Total Investor Accounts (all)	400,118	344,357	16%
AMC branch network	165	138	20%
New Funds/Plans launched	37	38	-3%

The Mutual Fund Industry currently manages total assets (including Open End, Close-End and Voluntary Pension Scheme) of PKR 540 bn on behalf of over 400 thousand investors in both conventional and Shariah Compliant Funds.

Board Review

The Board of MUFAP started its term on October 01, 2018. A number of matters taken up on the Regulatory and Taxation front by the previous Board had remained outstanding by the end of the term and this Board strived to resolve the outstanding tasks at the earliest.

The Board, with the proactive support by SECP, managed to resolve a number of Regulatory issues while limited progress could be achieved in the taxation matters due to lack of support and understanding at FBR and SRB/PRA. Most prominent of these issues include WWF on funds, zakat deductibility of funds and the matter of obtaining tax exemption certificates.

Here, I would like to present some important matters which were taken up by the Board during the year:

Sustainable Pricing Framework & Ease of Regulations

The mutual funds industry of Pakistan had been plagued by pricing oversight which had been excessively and arbitrarily introduced in the past from time to time. One of our major representations to SECP for a while has been to introduce a sustainable pricing framework and keep it consistent for atleast five years to enable the industry to develop its footprint in terms of branches and sales teams and spend on marketing and awareness programs.

The SECP during the year engaged in a comprehensive dialogue with MUFAP on this matter and proposed wide-ranging changes in the pricing regime of the industry. These include allowing charging different types of expenses within the overall expense ratio without any sub caps, including removal of the cap on management fee wherein AMCs have now been allowed to charge management fee within the Expense Ratio Caps. AMCs have also been allowed to charge selling and marketing expenses, including cost of alternative delivery channels expenses, to all categories of funds without any time and sub-limit. This will push the industry towards managing its costs more effectively while giving some flexibility on fee charged and without any extra burden on unitholders. This landmark change reflects SECP's vision to enable grass root industry growth and give financial empowerment to AMCs in their quest to develop their retail base.

In order to reduce the operational burden on AMCs, the SECP has also removed different requirements of regulatory approvals for mutual funds. AMCs are allowed to make changes in Constitutive Documents (other than changes in the Fundamental Attributes of the funds) with trustee's consent and without prior approval of SECP. Separate requirement for approval of the SECP for appointment of trustee of each new CIS has also been withdrawn. The measures have been introduced to facilitate the growth of the mutual funds industry and to provide a more facilitative and robust environment for the sector.

The SECP also took a major step in significantly reducing its annual monitoring fee for mutual funds which will improve investor returns and allow the AMCs to spend more on marketing and awareness activities. MUFAP team is now working with SECP on ironing out similar matters with the VPS funds. We are grateful for the support and understanding we have received from SECP at all levels.

New KYC/AML Regulations

During last year, SECP notified the Anti-Money Laundering and Countering Financing of Terrorism Regulations 2018 which are in accordance with Financial Action Task Force (FATF) recommendations. The Regulations emphasized enhanced focus towards high risk areas and taking a risk-based approach towards combating money laundering and financing of terrorism. The Regulations also envisaged greater self-awareness about AML/CFT and accordingly asked NBFCs to implement systems and controls that commensurate with their risk profile. SECP also conducted workshops and orientation sessions for industry operators to explain the new regime and clarify the requirements.

MUFAP and its members completely support a robust and effective KYC/AML environment; however, we also advocate a phase wise implementation of this comprehensive framework as it requires extensive upgradation of infrastructure, training and policy development at AMC level. AMCs IT systems and human resources need time to adapt to the new KYC Regime in order to incorporate a continuous monitoring mechanism and MUFAP has taken up with SECP to develop a timeline and roadmap as to how the AMCs will standardize the processes and details to be acquired from new investors along with a timeline for getting the same updated for existing investors. While strongly urging its members to comply with the new regulations in letter and spirit, MUFAP also feels that the AML framework needs to be consistent, clear and practically applicable and the SECP should measure members' compliance on a relative scale and exercise some forbearance in view of the practical difficulties involved in achieving compliance for legacy accounts.

MUFAP also evaluated joining in the Centralized KYC Organization (CKO) at NCCPL being introduced for Brokers. In our analysis it was assessed that the CKO is basically a third party verification of customer identification and offers no value addition to most AMCs who are already at fairly advanced level of introducing new systems and processes with respect to onboarding of customers. Therefore, MUFAP proposed to SECP to exclude mutual funds from the CKO regime due to limited value-addition and fear of adding a redundant operational layer to the on-boarding process. However, to help other capital market players who are now adopting the enhanced KYC framework, MUFAP has offered to voluntarily share all client data to the CKO regime as and when its ready.

TFC Pricing and Valuation Review

Due to lack of liquidity and inadequate trading data, non-market representative prices are being calculated from the current TFC Valuation Model for non-traded instruments. A Committee of MUFAP was formed review the TFC Valuation Model and proposed the following amendments in the Circular 33 of 2012:

1) To calculate the yields, all debt instruments shall be divided into two sectors (i.e. Shariah and Conventional) and separate yield matrix shall be calculated for each.
2) Due to lack of adequate trading data we propose that valuation be done once a month instead of fortnightly.
3) The number of trading days be increased from 15 days to 30 days and from 30 days to 60 days to increase the number of trades that can be captured.
4) We propose to use KIBOR instead of PKRV to calculate credit spreads as currently future cash flows are calculated on KIBOR while spreads are calculated on PKRV leading to a mismatch.
5) Enhancement in the maturity buckets by breaking the over 5 years bucket into two; namely 5-7 years and over 7 years.
6) To select the data point on which to make the matrix: use weighted average of all trading points available. All traded volume will be multiplied with their ratings weights.
7) Introduction of Floors and Caps based on one year rolling historical trading prices so the model calculated prices remain within the trading bands and not go to unrealistic prices.

The final draft of this initiative is under discussion between MUFAP and SECP and we hope that it will be implemented soon.

MUFAP Investor Awareness Program

Mutual fund industry's penetration into the retail investors is very low with retail assets currently constituting of around 37% of total assets of the industry. One of the major reasons for the same is lack of awareness amongst the general public. The lack of investment in retail segment and mass scale advertising to generate awareness about mutual fund industry are the main factors stifling its growth. Asset management companies are offering a diversified range of mutual and pension funds to meet the risk appetite of investors, yet lack of awareness is stifling industry growth. Asset management companies have been conducting awareness & marketing campaigns/ road shows/ seminars individually; however the outreach is too low due to limited resources. For long term sustainable growth of the industry, the retail investor base needs to significantly grow which can be better achieved by pooling resources. The Board of MUFAP has recently initiated work on a mass level investor awareness program for creating public awareness about mutual funds among the masses. The Board has proposed that the AMCs will contribute 0.02% (i.e. 2 paisas from the funds which shall be included in the allowable selling and marketing expenses) towards a mass scale investor awareness campaign. The amount will be pooled with MUFAP who will be leading the execution of the campaign. The campaign in the first phase will be on the basics of mutual funds with the intention to educate the general public about mutual funds and address the lack of knowledge on Mutual Funds and Fear of the unknown.

Digitization and Fintech - the way forward

The wave of digitization and technology that has transformed the financial markets globally is now touching the shores of Pakistan. Technology, which was once only confined to back-end fund management systems, transaction processing and customer servicing has now come to forefront to facilitate investments through digital modes. AMCs have started making significant investments in this area to offer choice and convenience for their clients. The Government and the Regulator, too, have played their part in furthering digitalization, especially through

their financial inclusion efforts. Remote on-boarding and transactions via internet portals and mobile phone applications are now being offered by many industry players. SECP has allowed the investments in technology as an allowable selling and marketing expense - thus encouraging AMCs to invest in this mode. MUFAP has also taken up with SBP and SECP to allow Mutual Funds' Trustees membership of NIFT and be allowed to maintain cash account with SBP. This will enable the investors of mutual funds to receive redemption money/payments directly into their accounts maintained with their banks and other facilities. This could be a ground breaking initiative to divert Government borrowing from banking system to public. We also feel that banks should encouraged to facilitate a payment platform whereby transactions can be done on a pull rather than a push mechanism, something similar to PayPal in the USA.

Future Outlook

Though the mutual fund industry recorded significant progress on many fronts last year, we are still quite far from utilizing our full potential. On almost on all parameters, our industry is far behind the developed markets and even most of the emerging economies of the world. The industry is confronted with number of challenges like low retail penetration ratio, a restricted product portfolio, lack of investor awareness, an un-even playing field vis-à-vis competition like NSS and lack of distribution support from commercial banking sector. For the industry has to utilize its potential fully, it has to address these challenges. The investor awareness program should help significant address the lack of awareness about mutual funds.

Acknowledgements

I would like to thank our Regulator, Trustees, my fellow Board members and MUFAP staff for their wonderful support throughout the year. I am particularly grateful to Mr. Aamir Khan, SECP Chairman, Mr. Khalid Mirza, SECP Chairman Security and Exchange Policy Board, Mr. Farrukh H. Sabzwari, Commissioner SECP, Mr. Shauzab Ali, Commissioner SECP, Ms. Musarrat Jabeen, Executive Director Specialized Companies Division, Mr. Muhammad Afzal, Director REITs & Pension, Mr. Waseem Khan, Additional Director PRDD Specialized Companies Division and entire AMCs and VPs teams at SECP for their proactive role in dealing with issues relating to Mutual Fund Industry and VPS. I am thankful to the Central Depository Company, MCB Financial Services and National Clearing Company of Pakistan for their continued support for the Mutual Fund Industry. I would like to thank the Senior Vice Chairperson Ms. Maheen Rahman, Vice Chairman Mr. Hasnain Raza Nensey, fellow Directors, Committee Chairmen and Committee Members for their dedication, teamwork and valuable support. Lastly, I thank Ms. Mashmooma Zehra Majeed and the management team of MUFAP for running the secretariat and assisting the Board on important matters.