Committee Reports

Accounts And Taxation Committee

(1 Meeting Held In The Year October 1, 2015 – September 30, 2016)

Member	Meetings Attended
Mr. M. Habib ur Rahman (Chairman)	1 of 1
Ms. Maleeha Bangash	1 of 1
Ms. Mashmooma Z. Majeed	1 of 1
Mr. Muhammad Murtaza Ali	1 of 1
Mr. Noman Ahmed Soomro	1 of 1

Member	Meetings Attended
Mr. Zeeshan Quddus	1 of 1
Mr. Muhammad Irshad Iqbal	1 of 1
Mr. Muhammad Khawar Iqbal	1 of 1
Mr. Mansoor Wahid Bux	1 of 1
Mr. Shoaib Umar Farooq	1 of 1

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 of Proposals for Federal and 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

Tax treatment of element of income and capital gains at the time to dividend distribution:

Pursuant to the amendments that were brought in through Finance Act 2014, bonus units were no longer allowed and mutual funds were mandatory required to make cash distribution to their unit holders to meet compliance with Clause 99 of the Second Schedule of the Income Tax Ordinance, 2001. Due to this change, investors who are investing later in the year are subjected to tax at an unfair rate as their capital is also taxed. An investor who invests nearer to June/ dividend distribution date may only receive his capital back (his dividend would comprise only of the element of income he brought in), which should not be taxed, but at time of distribution the dividend is distributed with equally for all investors as cash on which tax is required by law to be withheld, resultantly their capital portion is also taxed.

A working group of the committee looked into international jurisdictions; mainly the USA and UK laws in this regard. In UK they have element of income and therefore the same dividend is distributed to all investors. At the time of dividend distribution it is separately marked in their dividend warrant what amount was received as element of income from investor and the investor can file for a refund and gets that within two weeks. In Pakistan since the process of refund is not feasible, and while both MUFAP and SECP have been taking this matter up with FBR for the past three years that the tax deducted should exclude the portion of the element of income, the same has not been introduced. In the USA they don't have element of income as they have varying prices and varying dividends, in which the dividend will be what they have earned since investor joined the fund, hence there is no element of income booked. However introducing a variable pricing based on USA Model will be too difficult to understand by the investors in Pakistan at this point in time and hence the price should remain the same but varying dividend should be introduced.

Based on the above, the working group developed three separate cases:

- Case 1- Equal distribution to all unit holders (based on UK's model)
- Case 2- Variable dividend and variable pricing (based on USA's model)
- Case 3- Varaible dividend but same pricing (based on USA but modified for our jurisdiction)

These were then discussed and shared with Board along with the Committee's recommendation that Case 1 or Case 3 may be proposed to SECP for adoption along with the standardized methodology for calculation of element of income for adoption across in the industry.

Separate Tax Schedules for Mutual Funds, VPS and REITs

The SECP had suggested to MUFAP to develop separate Tax Schedules for Mutual Funds, REITS and Voluntary Pension Schemes (VPS) so that any amendments introduced for normal companies do not end up affecting mutual funds as mutual funds have a pass through status. In this regards, Committee developed the draft schedules and then the Board engaged the services of A.F. Ferguson & Co. to finalize the drafts. The tax schedules cover both the Fund and the investors and their respective taxation. The same were shared with the Board for their consideration and onward submission to SECP.

Budget Proposals for FY 2016/2017

The Committee also worked on the proposals for the Budget 2016/2017 which were as follows:

Introduction of Separate tax Schedules for Mutual Funds , REITs and VPS

100D should be inserted via Finance Bill to incorporate the Tenth Schedule for mutual funds which is read as 'rules for the computation of the income, profits and gains of mutual fund and collective investment scheme and related matters'

100F should be inserted via Finance Bill to incorporate the Eleventh Schedule for REIT Schemes which is read as 'rules for the computation of the income, profits and gains of REIT schemes and related matters'

100F should be inserted via Finance Bill to incorporate the Twelfth Schedule for Voluntary Pension Schemes which is read as 'rules for the computation of the income of participants of Approved Pension Fund and related matter'

Tax Credit for VPS Contributions

The committee proposed that the additional tax credit in VPS for persons joining the pension fund at the age of forty-one years or above on additional contribution of 2% per annum for each year of age exceeding forty years should be extended for another five years.

Taxation on Management Company

All service provider companies were required to pay a minimum tax of 1%. Under Finance Act 2015, it was changed to a minimum tax of 8% (12% for non-filer). This is an exorbitantly high rate of withholding tax for AMC. Due to low AUMs in Pakistan and requirement of high expenditure on marketing and distribution expenses, the industry is working at breakeven point. Any excess tax paid is adjustable against future tax liability. As most of the industry is working at low margins it is unlikely that excess tax will ever be adjusted. The flaw in tax law is that the tax authorities are treating all service industries as having same rate of profitability and hence same rate of withholding tax. The proposal was to reduce the rate back to 1% for AMCs.

Removal of FED

The committee again proposed that FED should be withdrawn on Asset Management Services. As the AMC`s are already subject to provincial sales tax on services, levy of FED is un-constitutional and causing double taxation.

Taxation of bonus shares under section 236 M and 236 N in the withholding section for Mutual Funds and Pension Funds

According to Sections 236M and 236N Bonus shares are taxable @ 5 percent of the specified value under FTR and the company issuing bonus shares is obliged to withhold tax from the shareholders. Since Mutual Funds and Pension Funds are exempt through Clause 47B from withholding from Dividend, Profit on Debt, Brokerage and Commission, it was proposed that Mutual Funds and VPS should also be exempted from withholding of tax under Sections 236M and 236N, so Sections 236M and 236N need to be added to Clause 47B, Part IV of the Second Schedule of the Income Tax Ordinance.

Technical Committee – Mutual Funds

(4 Meetings Held In The Year October 1, 2015 – September 30, 2016)

Member	Meetings Attended	Member	Meetings Attended
Mr. Yasir Qadri (Chairman)	4 of 4	Ms. Rida Jiwani	2 of 4
Mr. Imran Azim (Vice-Chairman)	3 of 4	Mr. Humbal Katia	1 of 4
Mr. Ali Alvi	1 of 4	Ms. Mashmooma Z. Majeed	4 of 4
Mr. Muhammad Imran	2 of 4	Mr. Muhammad Sohail Qadri	2 of 4
Mr. Muhammad Murtaza Ali	1 of 4	Mr. Mansoor Bux	3 of 4
Mr. Muhammad Asad	2 of 4	Mr. Shoaib Umar Farooq	3 of 4

TERMS OF REFERENCE

- To review Acts, Ordinances, Rules and Regulations, Circulars pertaining to mutual funds and VPS 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

ACTIVITIES' REPORT

The technical committee over the year worked on the following issues/items:

a) Expense ratio Limits for VPS funds:

The Technical Committee invited all the VPS managers to obtain their feedback on the SECP suggestion that MUFAP should propose expense ratios for VPS on similar lines as collective investment scheme. The VPS managers were of the view that VPS funds are too small right now and would have high expense ratio which will reduce once large fund sizes are achieved however agreed to propose to the Board that the same limits as introduced in the NBFC Regulations for Mutual Funds may be introduced for VPS as follows:

Management fee limit of VPS Sub-Fund should be

- Equity Fund should be increased from 1.5% to 2%
- Money market fund reduced to 1% from 1.5%
- Income fund should remain at 1.5%
- For cash settled gold sub fund is 1.5% and 1% deliverable gold sub- fund

The Expense ratio limit should be again same as CIS

- Equity up to 4%
- Debt up to 2.5%
- Money Market up to 2%
- Gold contract based upon 2.5% and deliverable up to 3.5%

This limit will exclude all government levies and taxes and SECP fee

- And also allow the reimbursement of 0.1% from funds in respect of accounting and valuation services.
- Shariah advisory fee should be chargeable to the VPS as allowed in CIS

b) Review of Companies Act 2016

The Committee had initiated review of the draft Companies Act 2015 shared by the SECP for public comments however the same was not completed.

c) Standardized KYC Policy

The Committee proposed a minimum standardized KYC Policy to be adopted by the mutual funds industry. The same divided the investors into three categories and defined minimum KYC standards for each category, namely:

1. Low Risk (Level I)

Individuals and entities whose identities and sources of wealth can be easily identified and transactions in whose accounts by and large conform to the known profile as per KYC form may be categorized as low risk.

2. Medium Risk (Level II):

Customers those who are likely to pose a higher than average risk to AMC may be categorized as medium or high risk depending on customers background, nature and location of activity, country of origin, sources of funds etc

3. High Risk (Level III):

The sales staff / distributor / facilitator may apply enhanced due diligence measures based on the risk assessment, there by requiring intensive 'due diligence' for higher risk customers, especially those for whom the sources for funds are not clear.

d) Review of Draft NCCPL Rules and working papers of CGT collected for mutual Funds

Pursuant to the amendments introduced in the Finance Act 2016, NCCPL has now been made the withholding agent for Capital Gains Tax (CGT) for mutual funds as well. This would enable the unit holders of mutual funds to get benefit from netting with the capital market transactions. In this regards the Committee reviewed in detail the draft working paper outlining the operational flow of information between NCCPL and AMCs with regards to the withholding of CGT at the time of redemption and draft Rules shared by NCCPL along with the comments received from the members on the same. The Committee finalized the comments and shared the same with the Board.

e) Comments on draft requirement for Active Allocation plans Offered under Collective Investment Scheme

The Committee reviewed the draft shared by SECP on the Active Asset Allocation Plans (AAAP) offered under Collective Investment Schemes. The main observations were that capping of number of AAAP under Fund of Funds (FOF) or Asset Allocation funds (AAF) to five would result in unreasonable delays in relation to launch of new plans that otherwise could be expeditiously attached to an existing FOF or AAF. By placing a limit would also result in higher expenses due to extensive documentation besides number of approvals separately required from Commission and other Regulatory authorities to launch new Fund with proposed allocation plan. Furthermore placing cumulative exposure limit of 20% in a single underlying equity CIS would negatively impact AAAP as FOF/AAF would be compelled to reduce exposure from well performing underlying existing equity CIS thus translating subsequently into lower returns earned by the respective FOF/AAF by virtue of 20% aggregate exposure limit. Frequent redemptions due to this condition would also keep Fund Manager of underlying equity CIS uncertain to allocate surplus cash in equity stocks in case if such underlying CIS has more FOF/AAF investors. This would also indirectly compromise the interest of unit holders of the underlying equity CIS. Proposed limit of 20% would clip the flexibility of taking further exposure into single underlying Equity CIS consequently resulting in further shrinkage of multiplier being used by CPPI based Scheme(s). Presently, the Commission already prescribed the multiplier band to be maintained by such scheme(s) from compliance perspective. The Committee recommended to the Board to recommend to SECP that there was no benefit of introducing such a circular and the same should not be introduced.

f) Peer Group Index Methodology

The Committee initiated work on developing a peer group index for money market category. The same is in development stage.

Technical Committee – Shariah Committee

(1 Meeting Held In The Year October 1, 2015 – September 30, 2016)

Member	Meetings Attended	Member	Meetings Attended
Mr. Muhammad Shoaib (Chairman)	1 of 1	Ms. Mashmooma Z. Majeed	1 of 1
Mr. Yasir Qadri	1 of 1	Mr. Mansoor Bux	1 of 1
Mr. Muhammad Asim	0 of 1	Mr. Shoaib Umar Farooq	1 of 1
Ms. Maleeha Bangash	1 of 1		

TERMS OF REFERENCE

- To view the concerns, obstacles and challenges and new development facing the Shariah Compliant (Islamic) Mutual Funds in Pakistan;
- Periodic and ad hoc review of standardized trust deed and offering document (at least Annual);
- To discuss the challenges faced by any Shariah compliant Mutual funds scheme or Shariah Compliant Asset Management Company;
- Committee shall include matters related to Product Development, Investment, Marketing, Operations and any other aspect of business having relevance from Shariah perspective as is relates to such Mutual Funds;
- To reach consensus across Managers of Shariah Compliant Mutual Funds, with a view to reach standardization of practice; To work towards standardization of code of conduct and practice for Shariah Compliant (Islamic) Mutual Funds in all areas including constitutive documents, SOPs etc.

ACTIVITIES' REPORT

The Committee discussed the following three main areas where issues were being faced by Shariah compliant funds:

a) Drafting of Standardized constitutive documents for Shariah compliant funds in agreement by the Shariah advisors (including the newly created Islamic finance division of SECP):

The Committee discussed that MUFAP and CDC with SECP approval had drafted the standardized constitutive documents which are being used by all new mutual funds however the Shariah advisor have concerns in the standardized document that they were drafted without input from Islamic scholars and tend to introduce amendments in same which delay the process. The committee therefore decided to draft the standardized consecutive documents for Shariah compliant funds in consultation with Shariah Advisors and trustees and same shall be approved with SECP after input from SECP's Islamic finance division, so that process of approval of documents becomes easy and efficient going forward.

b) Fixed Income/ Money Market Funds:

The Committee discussed that there are few issues with respect to fixed income funds which have been taken up to SECP from time to time and recently SECP suggested taking up these matters together in one document so the Committee recommended to the Board to send the following recommendations to SECP as follows:

- In the definition of cash and cash equivalent T-bills are mentioned however Sukuks are not mentioned for which our recommendation is that Sukuks should be included in cash and cash equivalent and the maturity time should be increased from 90 days to 180 days.

- There is requirement for Shariah compliant sovereign funds to maintain minimum investment in government securities of 70% which due to lack of new auctions for Ijarah Sukuks in the recent past led the fund managers with a dilemma of replacing their maturing stock of Ijarah with existing Ijarah of inflated prices in order to meet the 70% Ijarah Sukuks minimum requirement. It was proposed to recommend to SECP to reduce the minimum requirement to 51%.

- The Committee also proposed to the Board that the exposure limit for Shariah Money Market Funds of 15% limit on investment with a single bank is stringent and should be relaxed. Similarly the maximum exposure limit for Shariah compliant pension scheme should be reviewed with the purpose of relaxing exposure limit for a single bank (currently 10% for debt sub fund and 20% for money market sub fund) committee recommended enhancing the limit to 20% as well.

- The Committee discussed that Mutual Funds are restricted from participating in Bai Muajjal transaction carried out by SBP/GOP which results in them having less avenues to invest in. The Committee recommended to the Board to propose to SECP to take up this matter with SBP.

c) Shariah Compliant Voluntary Pension Scheme

Restriction on participation by Sub-Fund, if lead arranger is related party:

Any issue of corporate Debt where the related party is arranger, advisor or underwriter, then VPS fund is not allowed to participate in such an issue for six month from date of issue. The Debt Sub Fund and Money Market Sub Fund of VPS are therefore not able to participate in the IPO's. The Committee proposed that if the related party is an advisor or arranger then VPS sub funds should be allowed to participate in public offering. The restriction for underwriter should remain as there could be potential conflict of interest. The Committee proposed that this restriction should be relaxed for Shariah compliant as well as conventional Sub Funds.