CEO Review

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The financial year 2015-2016 continued to be very challenging for the mutual fund industry. With the continued changes in the tax laws affecting institutional investments in mutual funds over the past few years coupled with interest rates continuing in their declining trend and the stock market also remaining depressed most of the year, a major portion of industry remained affected by low returns and stagnant assets under management. The assets under management increased from PKR 443 billion on June 30, 2015 to PKR 490 billion as on June 30, 2016.

Economic Review

Pakistan's GDP growth recorded a growth of 4.71% in 2015-16 against 4.24% the last year. Inflation rate measured by the changes in CPI, averaged at 2.8% during July-April, FY 2016 against 4.8% in the comparable period last year. Core inflation during July-April FY 2016 recorded at 4.1% as against 6.9% during the same period last year.

Savings and Investments:

National Savings nominally increased to 14.6% of the GDP as compared to savings to GDP of 14.5% last year. Domestic savings were 8.3% of GDP in this fiscal year as compared to 8.4% of GDP last year. This is extremely low as compared to the region and the world and indicates that rigorous steps are required to promote savings and investments with major focus on investors' awareness and education as well as removing the taxation anomalies and regulatory issues hampering the growth. The Government should encourage long term investments and take measures to incentivize the long term savings.

Capital Markets Review

Equity:

The KSE-100 Index closed at 37,783.54 points up 9.84% from the last year. During the year, KSE-100 achieved a then all time high level of 38,777 points on June 17, 2016.

Also during current financial year, as a second phase of the Stock Exchanges Demutualization and Integration Act 2012, the three stock exchanges of the country i.e Karachi Stock Exchange (KSE), Islamabad Stock Exchange (ISE) and Lahore Stock Exchange (LSE) formally merged into single stock exchange on January 11, 2016 to become the Pakistan Stock Exchange (PSX). This is a vital step towards demutualization of the shares market in the country.

Debt:

The interest rates continued on its downward trajectory with the policy rate being reduced to 5.75%.

The growth of the economy is directly linked with the well developed corporate bond market which serves as an additional avenue for raising funds to meet their financing requirements. This avenue however remains majorly untapped with not many significant issues being introduced during the year.

Mutual Funds Industry Review

The assets under management increased from PKR 443 billion on June 30, 2015 to PKR 490 billion as on June 30, 2016 up 10.57% over last year. Due to low interest rates continuing, substantial outflow was witnessed in the money market catergory with majority of it being shifted towards the income categories during the fiscal year. Asset Allocation and Fund of Funds (with Allocation Plans) were the upcoming categories which witnessed a number of funds being launched and majority of the inflows in the year.

The equity fund category (both Conventional and Shariah Compliant) constituted of PKR 178.17 billion up 12.17% from last year followed by income fund category at PKR 127.73 billion up 25.83% and Money Market category at PKR 55.58 billion which was down 30.67% from the previous year.

Shariah Compliant funds category continued to remain the investors preferred mode of investment as this category received net inflows of PKR 25 billion during the year predominantly in the Fund of Funds and Asset Allocation category.

Voluntary Pension Schemes (VPS) registered net inflows of PKR 4 billion during the year with the total size of the VPS growing to PKR 18 billion (PKR 7 billion in Conventional and PKR 11 billion in Shariah Compliant Schemes).

Around Eighteen Thousand individual investors' accounts were added during the year. Due to unavailability of the unique identification data, it is difficult to determine the actual numbers that were added. In percentage terms, the holding of individuals in open-end mutual funds in terms of AUMs now stands at 34%.

Taxation Anomalies affecting the growth of the Mutual Fund Industry

It had been very unfortunate that the mutual fund industry has been plagued by various taxation anomalies and issues that have been growing every year rather than reaching any resolution. It is also unfortunate that the petitions filed in the Honourable Courts have been pending for years now with no progress. These are adding to the cost of management and affecting the return of the investor. The Government instead of facilitating savings and investments in the country has been hampering the same through taxation and other anomalies. MUFAP is persistently engaged with the SECP and the Government towards addressing these industry issues.

1. **Federal Excise Duty (FED):** FED was one of the biggest anomaly for the industry as FED is double taxation and is not tax neutral as the investors in mutual funds are already subject to provincial sales tax on services at 16%. Through the Finance Act 2016 the Government announced that the removal of FED on those services which are subject to provincial sales tax which included asset management services with effect July 1, 2016. Additionally in July 2016, the Honourable Sindh High Court also passed a judgment in our favour in the case that had been filed by the asset management companies, striking down the Federal FED component which was the same as the Provincial law. Federal Board of Revenue (FBR) unfortunately is unwilling to accept this and has challenged the same in the Supreme Court. Therefore although the funds have stopped further provisioning, they will be unable to reverse the provisioning till the Supreme Court's decision in the matter. We are hopeful that the Supreme Court will uphold the Sindh High Court's decision as with the recent amendments in the Finance Act 2016, the position of asset management companies is even more strengthened.

2. **Provincial Sales Tax on Services – Provincial Jurisdictions Issue:** The provinces have started claiming their share on the same service due to difference in the wordings of their respective laws and instead of resolving the issue by developing a sharing formula amongst themselves, are harassing the asset management companies. This matter should be settled directly between Provincial Governments or the Council of Common Interest should determine the formula for each province to settle the dispute between the provinces.

3. **Taxing Return of Capital:** Principal Component should be removed from dividend paid by mutual fund when withholding dividend tax. The amount invested by an investor includes a principal (capital) component in the price at which he invests. The cash dividend received by him may have been paid out of his principal amount, which will result in extra payment of tax. This tax anomaly should be removed so that the principal component of investment is not taxed as capital is not taxable.

4. **Imposing withholding tax on Mutual Funds and Approved Pension Fund whose income is exempt:** With effect from May 11, 2015, Federal Board of Revenue has required all entities whose income are exempt from income tax to obtain income tax exemption certificates from concerned commissioner of income tax otherwise its tax will be withheld at source and they would thereby need to file refund claims at year end. Collective Investment Schemes, Voluntary Pension Schemes, REIT Schemes, private equity and venture capital funds Modarabas, and all recognized provident, superannuation and gratuity funds have been affected by this move. This move has only created operational difficulties and departmental inefficiencies. The process of grant of exemption certificates is cumbersome and often the applications are rejected without a proper reason or are delayed. There is no tax revenue for the Government as the income of these entities is exempt from tax yet tax is being withheld and refunds are not made thereby affecting the investors.

5. **Super Tax Demands:** During the Financial Year some funds received notices from the Federal Board of Revenue (FBR) claiming Super Tax on income of those mutual funds. Preamble of Second Schedule provides that "incomes or classes of income, or persons or classes of persons, enumerated in Second Schedule shall be exempt from Tax, subject to conditions and to the extent specified therein". Therefore under Clause 99 of Part 1 to the Second Schedule, income of mutual fund has been exempted from tax. In the definition of tax, Super Tax is also included. We are of the view, which is also concurred by our tax consultants, that Super Tax proposed to be imposed under section 4B would not be applicable to a Mutual Fund which distributes ninety (90) percent of its income, other than realized and unrealized capital gains, in cash, to qualify for exemption under Clause 99 of Part 1 of Second Schedule to the Income Tax Ordinance. Currently the matter is being contested at the Income Tax Tribunal Level while a stay against recovery has been obtained from the Sindh High Court.

A level playing field between mutual funds and other savings and investment avenues is must for mutual funds and pension funds industry to grow and promote savings and investments in the country which is currently at the lowest in the region. MUFAP understands the significance of these taxation issues for investors and industry interest and is actively following up its resolution through the Courts and Government of Pakistan.

Amendments in the Non Banking Finance Companies and Notified Entities Regulations 2008

SECP introduced amendments in Non-Banking Finance Companies and Notified Entities Regulations, 2008 on November 25, 2015 in consultation with MUFAP. Some of the significant amendments are as follows:

1. Concept of Total Expense ratio has been introduced which includes introduction of category wise upper caps of Management Fee and Total Expense Ratio (TER). This aims to cap the maximum expenses that can be charged to the mutual funds. In addition a recent circular has introduced that any amount in access to the TER would be reimbursed by the AMC to the Fund. This remains a double edge sword as on one hand it would bring in discipline and reduce unnecessary transactions and churnings in the portfolio, on the other hand it can also potentially discourage to the Fund Managers to transact in fear of exceeding the TER even if those transactions are in the interest of the Fund's unit holders. It also remains ambiguous as to whether the AMC have to reimburse the management fee charged or the entire excess amount which could severely limit an AMC's capacity to expand.

2. Asset Management Companies (AMCs) have been allowed to undertake other fund management activities including REIT management services and management of private pool of funds (private equity) after meeting the additional equity requirements. Earlier separate companies had to be formed which had been one of the deterrents in launching Real Estate Investment Trusts (REITS) and Private Equity Funds.

3. Registration of Distributors would now be done by the SECP wherein the Distributors would be issued investment advisory licenses by SECP to distribute mutual funds as well. The regulatory framework for registration with the SECP as a distributor is in process of finalization and the SECP has advised that MUFAP to continue registration/ renewal of registration of RSPs till such time that the new framework comes into force.

The final notification also included certain amendments that were not in the original draft shared for public xxcomments and therefore were not discussed before the notification with MUFAP and other stakeholders. We have raised this issue with SECP and proposed some amendments in the same.

Board Meetings/ Attendance

MUFAP's Directors have been extremely generous in giving their time and expertise for industry issues. During 2015/2016 tenure of the Board, seventeen meetings were held of the Board of Directors. The attendance recorded at the meetings of the Board of Directors for 2015/2016 is summarized as below:

S.No	Name of Directors	No. of Meetings Attended (17)
1	Mr. Shahid Ghaffar - Chairman	17
2	Mr. Yasir Qadri* - Senior Vice Chairman	10 out of 12
3	Mr. Imran Azim - Vice Chairman	17
4	Ms. Mashmooma Z. Majeed - Chief Executive Officer	17
5	Dr. Ali Akhtar Ali	14
6	Mr. Mohammad Shoaib	13
7	Ms. Maheen Rahman	9
8	Mr. Rehan Nabi Shaikh***	6 out of 15
9	Mr. Mir Muhammad Ali*	5 out of 6
10	Mr. Imran Motiwala	5
11	Mr. Shahzad Jawahar**	2 out of 13
12	Mr. Babar Ali Lakhani	0
13	Mr. Farid Ahmed Khan***	0 out of 1

* Mr. Mir Muhammad Ali was director and Senior Vice Chairman till February 12, 2016.
The Board co-opted his successor Mr. Yasir Qadri as the Director and Senior Vice Chairman from February 12, 2016.

** Mr. Shahzad Jawahar resigned from the Board with effect from July 18, 2016.
The Board co-opted his successor Mr. Imran Hafeez as a Director from October 3, 2016.

*** Mr. Rehan Nabi Shaikh resigned from the Board with effect from August 31, 2016.
The Board co-opted his successor Mr. Farid Ahmed Khan as a Director from September 2, 2016.

We would like to place on record appreciation for Mr. Mir Muhammad Ali and Mr. Rehan Nabi Shaikh for their valuable contributions and endeavours towards MUFAP and the development of Mutual Funds Industry throughout their association with the industry.

21st Asia Oceania Investment Fund Association (AOIFA)

MUFAP was scheduled to be hosting the 21st Asia Oceania Investment Fund Association (AOIFA) in April 2016. Extensive preparations were underway however due to the uncertainty in the country's law and order situation around that time we unfortunately had to cancel the conference at the eleventh hour and are hopeful to host the one in 2019.

Public Awareness and Education to expand the Retail Investor Base

It is imperative for long term sustainable growth of the mutual funds industry that the retail investor base increases. Asset Management Industry vis-a-vis the Banking Sector presents a bleak picture, not only in terms of assets under management, but also with regard to participation and outreach to the general public. Currently, asset management companies are offering a diversified range of mutual and pension funds to meet the risk appetite of investors, yet the awareness in the masses is lacking of the options available to them. We hope to receive continued support from asset management companies to conducting public awareness marketing campaigns as well as awareness road shows/seminars from MUFAP's platform to bring across to the attention of the individual investors, the diverse investment features and benefits that mutual funds and voluntary pension schemes offer to them. The Government and SECP are also requested to facilitate asset managers to promote, educate and encourage investors to save.

Public Awareness/ Campaign

MUFAP is developing an awareness campaign on ‘what is Mutual Funds’ on Electronic Media (Television and Radio). Presently majority of the public is not even aware that mutual funds are an option for savings and investments and the purpose of this to simply introduce to the general public what are mutual funds so that the mutual fund as a viable saving option can be established.

MUFAP is also working on a press advertisement as a part of the Jama Punji Campaign with SECP.

Capital Market Hub/ Sarmayakari Markaz

The Chairman SECP Mr. Zafar ul Haq Hijazi inaugurated the Abbottabad Sarmayakari Markaz on November 12, 2015.The Abbottabad Sarmayakari Markaz is the country’s first capital market business hub. The hub will serve as a central location with presence of all major capital market entities at a single point. Six asset management companies are part of this Hub. The establishment of Abbottabad Sarmayakari Markaz will provide opportunity of saving and investments to the people of Abbottabad.

Acknowledgement

I would like to thank SECP for their continued support. I am particularly grateful to Mr. Zafar-ul-Haq Hijazi, Chairman SECP, Mr. Zafar Abdullah, Commissioner SECP, Mr. Akif Saeed, Commissioner SECP, Mr. Imran Inayat Butt, Executive Director Specialized Companies Division, Mr. Muhammad Afzal, Director REITs & Pension and the entire AMCs, Pensions and Strategy, Development, Investor Education Teams for their proactive role in dealing with issues relating to mutual funds and VPS.

I would especially like to thank the Chairman MUFAP Mr. Shahid Ghaffar for his continued support and guidance in strengthening MUFAP. I would like to thank Senior Vice Chairman Mr. Yasir Qadri, Vice Chairman Mr. Imran Azim and Board of Directors and Committees’ Members for their guidance, dedication, teamwork and support. Lastly, my thanks and appreciation for the management team of MUFAP for their continued hard work and commitment.