



## *Chairman Review*

### **Mr. Shahid Ghaffar**

Chairman, Mutual Funds Association of Pakistan

#### **Industry Review**

This year has been very challenging for the mutual fund industry with continued changes in the tax laws adversely affecting institutional investment in mutual funds. Declining interest rates and mostly bearish market conditions during the year under review further hindered growth of the mutual fund industry.

The mutual fund industry closed the financial year at PKR 490.37 billion up 10.57% over last year. The Equity Funds 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.

The Shariah compliant funds category continued growing faster than the conventional category and closed the year at PKR 157.49 billion, recording the growth of 26.78% over the previous year. A variety of mutual funds are being offered in this category to suit the varied needs of investors by asset management companies.

#### **Board Review**

The present Board of MUFAP started its term on October 1, 2015. The Board had identified three key areas to focus on during the year which were as follows:

##### **1. Making MUFAP independent and proactive**

During the year conscious efforts were made to make the management of MUFAP more independent by enhancing the role of the Chief Executive in running the day to day affairs and restricting the role of the Chairman and Board of Directors to policy decision making. This year various steps were taken to empower the Chief Executive, to make the institution stronger. The CEO was the sole representative of MUFAP with the SECP and various Government agencies. I am pleased to report that there has been significant improvement in the capacity building of the management team under the leadership of its Chief Executive.

## 2. Resolution of outstanding issues with FBR

Taxation issues have always been at the forefront every year and takes up majority of the time and effort of MUFAP's Board and Management. This year the two major issues taken up were charging of FED on asset management services and the taxing of return of capital included in the dividend payment.

On FED issue we had major success on two fronts, the Government finally accepted that the FED on services was leading to double taxation as the same was already being charged at the provincial level by the provinces and since it was a provincial matter after the 18th Amendment the Government withdrew the FED on Services already subject to provincial sales tax in the Finance Act 2016 effective from July 1, 2016. In addition, in July 2016, the Sindh High Court also passed a judgment in the case filed by the asset management companies, striking down the Federal FED component which was the same as the Provincial law. The FBR unfortunately is unwilling to accept this and has challenged the same in the Supreme Court even though the Federal Government's position on the same is also clear with the removal of the FED on Services which are subject to provincial sales tax. Therefore although the funds have stopped further provisioning from July 1, 2016, they will be unable to take a decision on the reversal before Supreme Court's decision in the matter.

The issue pertaining to return of capital is still under discussions with SECP and FBR.

## 3. Element of income and its taxation/accounting treatment so the investors are not disadvantaged due to unjust taxes on return of their capital

Pursuant to the amendments that were brought in through the Finance Act 2014, mutual funds are now mandatorily required to make cash distribution to achieve the tax free status. Due to this change, those investors who are investing later in the year are subjected to tax also on the portion of dividend that pertains to the portion of capital being returned to them (i.e. element of income received from them at the time of investment to equalize the dividend distribution). 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 since the dividend is distributed equally for all investors as cash on which tax is required by law to be withheld, resultantly their capital portion also gets taxed. To come up for a solution for this matter so that the investors are not taxed unjustly, the MUFAP had formed a Committee to study the different jurisdictions and make recommendations accordingly to resolve this issue. Internationally in most jurisdictions including the USA, varying dividends are paid to the investors based on the period of their investment. I am pleased to report that MUFAP has worked extensively on this subject and after finalization has already submitted its recommendations to the SECP. Resolution of this issue would address the tax anomalies for the mutual fund investors and help towards the growth of the mutual fund industry.

## 4. Outstanding Issues with SECP:

SECP had introduced amendments in Non-Banking Finance Companies and Notified Entities Regulations, 2008 on November 25, 2015 in consultation with MUFAP. Most of the amendments introduced were in consultation except the following which MUFAP has taken up with the SECP:

### I. Clause 38A. Responsibilities towards Corporate Governance and Proxy Voting.

Practically and operationally it will be very difficult for an asset management company to comply with requirements laid down in Rule 38A. Also there is inherent confidentiality conflict as the results are to be disclosed in the annual reports of the CIS. Therefore we have proposed certain amendments in this clause to make it implementable.

### II. Clause 58 (1) (k) Borrowing by CIS to meet redemption requests.

There are certain anomalies in this clause which can cause systematic risk to the Funds and MUFAP has proposed some amendments in the Regulation which are under discussion with SECP.



## Significant Developments during the Year

### CGT regime for investors of open end mutual funds

The Finance Act 2016 has changed the withholding tax regime for capital gains tax (CGT) and authorized National Clearing Company of Pakistan Limited (NCCPL) as the withholding agent for open end mutual funds as well. As a result, the unit holders of open end mutual funds would also be able to benefit from the netting regime across the capital markets, commodities and mutual fund industry. NCCPL and MUFAP representatives are working on a proposed mechanism for the determination, computation, collection and deposit of CGT in a centralized manner.

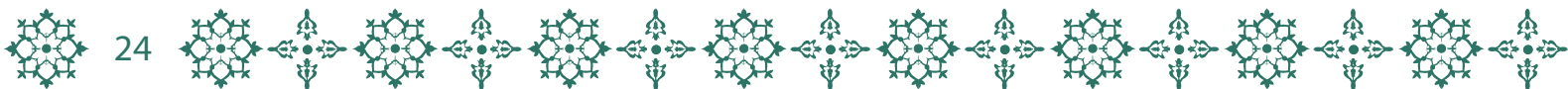
### Conversion of MUFAP into Self Regulatory Organization (SRO)

The SECP in September 2015 shared a concept paper wherein it proposed that MUFAP may be converted from trade organization to SRO, which will enhance the integrity and growth of industry. The proposed SRO will play a proactive role for the development of Mutual Funds Industry and for the protection of Investors. The SECP's concept paper had listed the following as the possible areas/functions for the SRO:

1. **Registration of members and mutual fund distributors**
  - All NBFCs holding AMC/IA license shall be registered with the proposed SRO
2. **Monitoring conduct of members and mutual fund distributors**
  - Formulate set of rules and regulations to govern the conduct;
  - Supervise to assess compliance with the rules and regulations
  - Take disciplinary measures against any misconduct and non-compliance
3. **Promote investor education and awareness program**
  - Support and sponsor educational programs, meetings and seminars to increase financial literacy and financial inclusion.
4. **Research and development**
  - Separate research and development function targeted at developing new products, improving risk management, evolving governance standards and achieving cost effective regulations.
5. **Certification programs for members and mutual fund distributors**
  - Conduct certification examinations to enhance the knowledge and educational standards of professionals

The said concept paper has been discussed in great detail in various meetings at MUFAP's Board. The matter was also discussed in detail in the EOGM of MUFAP specifically held to discuss the proposal of SECP for SRO status for MUFAP on July 15, 2016. The Members of MUFAP in the said EOGM have in principle approved the proposal of SECP for an SRO status for MUFAP subject to following conditions:

1. The member Asset Management Companies will not share any additional financial burden.
2. The Membership of SRO should be limited to mutual funds industry and the majority representation on the Board should be from AMCs. Independent directors should not be more than one third of the total composition of the Board and should have requisite knowledge of the mutual fund industry.
3. The SRO should have very well defined Terms of Reference (TORs) to be mutually agreed between SECP and MUFAP with the roles and responsibilities of SRO as front line regulator of mutual fund industry very clearly defined to ensure sufficient autonomy with SRO as well as avoid duplication of work. The SRO should be evolved in a phased manner with the TORs containing the phase wise implementation steps along with pre defined timelines of the various areas to be covered by the SRO.
4. Sufficient resources should be allocated to SRO so that it is financially and administratively viable while maintaining independence. Since SRO will assume some of the functions presently done by SECP, a portion of the fees generated by SECP from mutual fund industry should be allocated towards the SRO by amendments in the Regulations so that it has financial muscle for its capacity building and for meeting its day to day expenditure. Initial funding is required at the time of setting up the SRO for its capacity building to be generated from sources other than asset management companies.



Also the possibility of setting up an endowment fund initially through funding from SECP or international donor agencies should be considered.

Our Comments on the points mentioned in the concept paper were that monitoring of conduct of members is not an area we are ready to even consider in the first phase. Internationally also this is limited to compliance to the guidelines and standards made by the SRO and not the rules and regulations of the Regulator. The remaining points MUFAP has been doing in its existing capacity as much as possible in its limited financial capacity which conversion into an SRO may not address if adequate funding is not available.

### Future Outlook

The future of the mutual fund industry is dependent on increasing awareness about the mutual fund industry and enhancing the outreach to investors across the country. Over the past few years there has been gradual increase in the retail base which is presently around 34%. 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. Asset management companies have started conducting awareness & marketing campaigns/ road shows/ seminars individually as well as from MUFAP and SECP's platform. AMCs are also trying to enhance their distribution network. This will help in further enhancing the investor base of the mutual fund industry.

### Acknowledgements

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. Imran Inayat Butt, Executive Director Specialized Companies Division, Mr. Muhammad Afzal, Director REITs & Pension and entire AMCs and VPS team for their proactive role in dealing with issues relating to mutual funds industry and VPS.

I am thankful to the Finance Ministry, SECP and CDC for their continued support to the mutual funds industry.

I would like to thank the Senior Vice Chairman Mr. Yasir Qadri, Vice Chairman Mr. Imran Azim, fellow Directors, Committees' Chairperson and Committees' Members for their dedication, teamwork and support. I would also like to place on record appreciation for Mr. Mir Muhammad Ali who was Senior Vice Chairman till February 12, 2016 for his valuable contribution and endeavors for the development of Mutual Funds Industry. Lastly, my thanks and appreciation to Ms. Mashmooma Zehra Majeed and the management team of MUFAP for their continued commitment and hard work.

