CEO Review

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Economic & Capital Markets Review

Pakistan continued to face multiple challenges on economic front. Between January to June 2018, State Bank of Pakistan hiked discount rates by 75 basis points to 6.50% from 5.75% last year. However subsequent to that, two sharp 100 basis point increases have already been seen bringing the discount rate to 8.50% by September 30, 2018. Pakistani rupee too has been devaluing since December 2017. In June 2017, the value of Pak Rupee per US dollar was around 104.86 but it observed a steep decline reaching to around 121.73 in June 2018 and has lost almost 16% of its value over the year. The Pak Rupee has further lost value and currently is hovering around 134 per US dollar. Both these caused a great shock to the macroeconomic situation as it gave rise to many more problems the economy is currently facing. Apart from this, the country's economy is facing a sizable increase in current account deficit and fiscal deficit. The resultant situation is worrisome as slow economic growth and increasing fiscal imbalance is preventing the Government to cater the needs of the growing population.

Continued deterioration of the external current account, Moody's downgrading of Pakistan outlook and uncertainty on Pakistan's inclusion in FATF grey list eroded the investors' confidence and the KSE-100 index continued its downward trend over the year, declining by 10% over the year from the 46,565.29 level on June 30, 2017 to 41,910.90 level on June 30, 2018 as concerns on the microeconomic and political front remained prevalent. On August 03, 2017, the KSE 100 reached the peak of 47,084 index, before it started moving down and touched the lowest 37,919 Index on December 19, 2017. At the start of new calendar year 2018, the market gained momentum and started moving upwards but the movement was kept range bound due to weak economic indicators.

Mutual Fund Industry Review

As at June 30, 2018, there were 19 Asset Management Companies managing 259 funds including open-end, closed-end funds and Voluntary Pension Schemes while the total assets under management (AUMs) of the mutual fund industry stood at PKR 610 bn. Equity funds (both Conventional and Shariah Compliant) dominated the AUMs of the industry with the largest share of the mutual fund industry at PKR 231 bn amounting to a market share of 38%. Money market funds (both Conventional and Shariah Compliant) at PKR 131 bn held the second largest industry share at 21%, followed by Income Funds (both Conventional and Shariah Compliant) at PKR 89 bn with industry share of 15%.

During the year, 38 new funds were launched under Shariah Compliant Equity, Shariah Compliant Fund of Funds, Shariah Compliant Income, Shariah Compliant Asset Allocation, Shariah Compliant Money Market, Conventional Fund of Funds, Conventional Capital Protected, Conventional Equity and Conventional Income categories while 13 funds matured during the year. Overall, the industry witnessed net sales of PKR 32 bn mostly in the fixed income/ money market and Fund of Funds (CPPI) categories. Equity and equity based categories saw net outflows over the year as the stock market remained choppy. Conventional equity category was the only exception that witnessed net inflow of PKR 2 bn. The Shariah Compliant Funds (all categories included) which have been leading the industry growth over the past few years saw net inflows of PKR 7 bn while the conventional category this year witnessed net inflows of PKR 22 bn mainly in the money market funds category. This year also saw the winding down of the Gold Funds as the Gold as an asset class has been stagnant for a number of years now.

Voluntary Pension Scheme (VPS) registered net inflows of PKR 3 bn during the year with the total size of VPS growing to PKR 9 bn in conventional and PKR 17 bn in Shariah compliant category.

Around 39 Thousand individual investor accounts were added during the year. In percentage term, the holding of individuals in open-end mutual funds in term of AUMs (excluding fund of funds) has reduced slightly and now stands at 38.05% versus 39.65% the last year.

Key Regulatory developments during the year to promote growth of the Mutual Funds Industry

A very proactive approach was adopted by the Securities and Exchange Commission of Pakistan (SECP) and 7 meetings of MUFAP's Board were held with the Chairman SECP and Commissioner Specialized Companies Division SECP and SCD Team over the year leading to a resolution of a number of long outstanding issues as well as initiating discussions on new matters.

Element of Income

SECP notified the amendments in NBFC Regulations pertaining to change in accounting treatment of element of income vide S.R.O. 354 (1)/2017 in August 2017.

The amendments include insertion of a new clause defining the term 'Element of Income' a definition which was absent in NBFC regulations earlier. Another key change has been made in the Schedule V related to 'disclosure requirements by collective investments schemes' to be filed by the asset management companies in their annual reports to bring it more in line with International Financial Reporting Standards. In the new format, element of income would no longer be reflected in the profit and loss statement and will now be reflected in unit holders fund. An additional disclosure will be included in the Income Statement which would bifurcate the Income for the year as follows:

- Income already paid to outgoing unit holders on redemption of units
- Accounting income available for distribution:
  - Relating to Capital Gains
  - Excluding Capital Gains

Additionally, "Distribution Statement" has been deleted and its contents merged with "Statement of Unit Holders' Fund".

This notification has removed a major anomaly in accounting of open-end funds, whereby for maintaining "dividend equalization" part of "capital" contributed on incoming units was recognized in the income statement which was against the IFRS guidelines. MUFAP subsequent to the amendments, issued an explanatory circular for standardization of accounting, financial and tax treatment of element of income so that uniform accounting practices for element of income are followed across the industry.

A significant consequence from these amendments will be that variable dividends will be issued by the open-end mutual funds i.e. dividend rate will be different for each unitholder depending on the period they were invested in the Fund. The rate of dividend distribution shall vary depending upon the date of purchase of units. This will address the long outstanding issue wherein the capital invested by the unitholder (in the form of element of income) was also taxed at the time of dividend distribution. For the purpose of disclosure, the fund shall announce the per unit rate based on entitlement of dividend on units that were held for the entire period. Similarly, dividend yield shall be calculated based on opening NAV and dividend payable on units held for the entire period.

Product Diversification

AMCs have been re-allowed to launch constant proportion portfolio insurance (CPPI) based collective investment schemes to enable the industry to diversify its products and offer investors more options to invest. Subsequent to these amendments, a number of such funds were introduced during the year.

Liquidity Management of Mutual Funds

In order to facilitate the mutual fund industry, requirement for maintenance of minimum cash and cash equivalents for equity funds has been withdrawn. Requirement for maintaining committed credit lines for equity funds has also been withdrawn. This eased up the liquidity available to equity funds to invest further in the stock market.

Increasing distribution outreach

SECP had initially allowed AMCs intending to increase their outreach beyond big cities to charge 0.4% of marketing and selling expenses to open-end equity, asset allocation and index funds. The objective of this initiative was to increase the retail penetration of mutual funds and distribution network of AMCs across the country in cities outside of the main cities of Karachi, Lahore, Islamabad & Rawalpindi. In June 2018, the SECP issued a Circular allowing the selling and marketing expenses to be charged to all categories of funds (except fund of funds and money market funds) in all branches in all cities. MUFAP has further taken up with SECP for the removal of the December 31, 2019 deadline and introducing a more holistic branch expansion schedule instead of the current one which cites absolute numbers of branches in a year making it difficult for small size AMCs to achieve.

Risk Management and Control Guidelines for Asset Management Companies

The SECP issued guidelines for risk management systems and controls in Asset Management Companies. The purpose of these guidelines is to facilitate and guide the AMCs and provide a general framework of risk management. The guidelines provide a useful reference for AMCs in developing and assessing their own risk management systems.

Anti-Money Laundering and Countering Financing of Terrorism Regulations 2018

The SECP notified the Anti-Money Laundering and Countering Financing of Terrorism Regulations 2018. The Regulations are in accordance with Financial Action Task Force (FATF) recommendations. The Regulations emphasize enhanced focus towards high risk areas and taking a risk based approach towards combating money laundering and financing of terrorism. The Regulations also envisage greater self-awareness about AML/CFT and accordingly enabling NBFCs to implement systems and controls that commensurate with their risk profile. MUFAP's KYC Committee is currently working over the standardization of KYC and AML documentation and processes across the industry under these Regulations.

Conversion of MUFAP into Self-Regulatory Organization (SRO)

In September 2015, SECP had shared a concept paper wherein it has proposed that MUFAP may be converted from an association to a SRO along with an envisaged role for the SRO. After extension discussions in various board meetings MUFAP's then Board and later the Members in the EOGM held on July 15, 2016, had approved the conversion subject to the condition that the AMCs will not share additional financial burden and majority representation should be from the AMCs on the Board. The same had been shared with SECP with the proposal that SECP reduce its annual fee by 40% and allocate that to the SRO as the SRO will be performing a number of functions currently being done by SECP however, the SECP had expressed their inability to share a portion of its fees with SRO and the matter had been put on hold. During the year, the matter remained under discussion in the SECP-MUFAP meetings but no further progress could be done as the matter of arranging adequate funding for the SRO could not be settled as the amount proposed to be contributed by SECP was too low and the members of MUFAP are already struggling financially to bear the administrative and operational expenses of the Association and are not in any position to contribute what is needed to set up a financially independent and robust SRO. If SECP agrees to allocate a part of fee it receives from mutual fund industry to the SRO, MUFAP can easily and effectively undertake the dual task of promoting the industry and being the front line regulator.

Taxation Issues

The taxation matters unfortunately remained unresolved during the year in spite of very proactive efforts made by the Chairman Accounts and Taxation Committee, Mr. Razi-ur-Rahman Khan and MUFAP for the resolution of the taxation issues plaguing the mutual funds industry.

- Minimum Tax

Minimum Tax imposed on the Asset Management Companies at 8% is seriously impacting the growth of the mutual fund industry by unjustly levying corporate tax at multiples of what their actual tax liability should have been had the normal applicable Corporate tax rates been applied. 11 out of 19 AMCs are affected by this and other companies providing services including trade associations such as MUFAP. AMCs, by their very nature of business, cannot pass on the additional tax impact to the Funds that they manage. AMCs revenues (primarily management fee for managing mutual funds) is regulated by the SECP and the same is capped. Consequently, AMCs cannot increase their management fees to adjust for minimum tax. Furthermore, an overall expense ratio of the Fund is also capped, as per NBFC Regulations. The Federal Government has granted relaxation of minimum tax at reduced rate 2% instead of 8% to the companies engaged in 18 sectors over the past three years to grant AMCs the same relaxation and this matter is being actively pursued by MUFAP with FBR and Ministry of Finance for the past three years at all levels without much effect.

- Requirement for obtaining Exemption certificates under Section 159(1) of the Income Tax Ordinance 2001

Mutual Funds (CIS), Provident Funds, Pension Funds, VPS and some other Entities are exempt from withholding of taxes according to the Income Tax Ordinance, 2001 beacuse their income is exempt. This specifically means tax of CIS should be withheld by any party making payment to the CIS. However, FBR issued a clarification on May 12, 2015, according to which it made mandatory for every exempt entity including CIS to apply for exemption certificate under Section 159 to claim exemption from withholding tax. The same was included in our Budget proposals since 2015, however, it wasn't made part of the Finance Act to date.

- Provincial Sales Tax on Services - Provincial Jurisdictions Issue

The provincial sales tax levied from July 2011 is not tax neutral as this tax is not borne by investors directly investing in securities. As such this tax is against the principle governing taxation of mutual funds. As most of the AMCs and mutual funds are registered in the province of Sindh, and the sales tax is being paid in Sindh. The law governing Sindh Sales Tax enacted by Sindh Revenue Board (SRB) states that sales tax to be provided where business is registered. Meanwhile the Punjab Revenue Authority (PRA) law states that sales tax to be provided where business is provided. From the financial year 2014, the PRA also started demanding Provincial Sales Tax on the plea that some unit holders are resident in Punjab and demanded a share based on population of the provinces. MUFAP made representation to PRA that tax has been paid to SRB and they should reslove the same with SRB without any resolution. Therefore AMCs had to obtain stay order from the Honorable Sindh High Court against the tax demanded by the PRA which is still outstanding and AMCs keep getting notices periodically. This matter needs to be settled at the Council of Common Interest which should determine the formula for each province.

Board Meetings and Attendance

MUFAP Directors have been extremely generous in giving their time and expertise for industry issue. During 2017-2018 tenure of the Board, 16 meetings were held of the Board of Directors. The attendance recorded at the meeting of the Board of Directors for 2017-2018 is summarized below:

No.	Name of Directors	No.of Meetings Attended (16 meetings held)
1	Mr. Yasir Qadri, Chairman	14
2	Mr. Muhammad Saqib Saleem, Senior Vice Chairman	6
3	Mr. Adeel Ahmed Khan, Vice Chairman	14
4	Ms. Mashmooma Zehra Majeed, Chief Executive	16
5	Mr. Imran Azim	14
6	Mr. Mohammad Shoaib	13
7	Mr. Razi-ur-Rahman Khan	13
8	Dr. Amjad Waheed	11
9	Mr. M. Habib-ur-Rahman*	8 out of 8
10	Mr. Khaldoon Bin Latif	8
11	Mr. Muhammad Abdul Samad**	6 out of 7
12	Ms. Tara Uzra Dawood	5
*Resigned on March 19, 2018 **Co-opted on May 4, 2018		

Appreciation

We would like to place on record appreciation for Mr. M. Habib-Ur-Rahman and Mr. Shahid Ghaffar for their valuable contributions and endeavors towards MUFAP and the development of Mutual Funds Industry throughout their association with the industry. MUFAP has made a lasting contributions towards the betterment of the mutual fund industry under their wise counsel for which they will be fondly remembered. Our need to benefit from their knowledge, wisdom and counsel will always remain.

Mr. M. Habib-ur-Rahman has played a leading role in the development and strengthening of MUFAP throughout its existence. He made lasting contributions towards the betterment of the mutual fund industry under his wise counsel. He worked quietly and selflessly on different issues, but especially in areas of taxation and regulation. He also served extremely well in the forefront twice as Chairman. With his wise counsel, leadership and his strong professional background he has been enormous help to the industry in the difficult years. His amiable personality and willingness to give his time for the industry were his endearing qualities.

Mr. Shahid Ghaffar has played a leading role in the development and strengthening of MUFAP especially during his last tenure as Chairman. With his wise counsel, able leadership and his strong commitment and professional background he has made valuable contributions to MUFAP on many regulatory and taxation matters and professional issues throughout his association with MUFAP and been enormous help to the industry in the difficult years. Many times it was his foresight which enabled MUFAP to take beneficial decisions. He was always forthcoming and encouraged open dialogue and critical analysis as a Chairman of Board, Committees and member.

Acknowledgements

I would like to thank SECP for their continued support. I am particularly grateful to Mr. Shaukat Hussain, Chairman SECP, Mr. Zafar Abdullah, Commissioner SECP, Mr. Tahir Mahmood, Commissioner SECP, Mr. Shauzab Ali, Commissioner SECP, Mr. Imran Inayat Butt, Executive Director Specialized Companies Division, Mr. Muhammad Afzal, Director REITs & Pension, Mr. Waseem Khan, Additional Director PRDD SCD, and entire AMCs, Pensions, Strategy Development and Investor Education teams for their proactive role in dealing with issue related to mutual funds and VPS.

I would like to thank the MUFAP Chairman Mr. Yasir Qadri, Senior Vice Chairman Mr. M. Saqib Saleem, Vice Chairman Mr. Adeel Ahmed Khan, Board of Directors and MUFAP 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.