Chairperson Review

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Economic & Capital Markets Overview

The Fiscal Year 2019-20 proved challenging for the country as well as the rest of the world due to the unprecedented impact of the Covid19 pandemic. A fragile economic recovery began to be visible towards the 4Q2019; however by March 2020, Pakistan entered into a severe countrywide lockdown to control disease spread. This dented aggregate demand and industrial output with real GDP growth slumping to -0.38% in FY20 as compared to 1.91% in the FY19. Subsequently, blanket restrictions began to be lifted in May 2020 with the Government introducing smart lockdowns and allowing partial resumption of the economic activity particularly in the north of the country with strict measures in place to control localized outbreaks. These were successful in reducing overall spread and the country returned to partial economic activity and normalcy by September 2020.

Regulatory and government action particularly from the Securities and Exchange Commission of Pakistan, along with the State Bank of Pakistan and various government ministries was swift and effective in providing much needed liquidity and relaxation to companies, financial institutions and industrial units to mitigate the effects of the lockdown. A sharp reduction in interest rates by 625bps, relaxations to both borrowers and lenders, social safety net distributions along with significant relief to industries was helpful in reducing overall stress on the financial system.

For equity markets, FY19/20 was a rollercoaster year. During the first half of the year, the stock market recovered sharply from a low of 28,000 and bounced back 43,468.22 in January, 2020. As the global impact of Covid19 became more apparent, there was heavy sell down on the PSX. The market reacted to the social and the economic cost of Covid19 on Pakistan with March being the worst month of FY20 where the index dropped by a whopping 23.04%. However, as relief measures kicked in and the economy began to open up, the KSE 100 demonstrated a sharp V-shaped recovery and bounced back up to pre-Covid19 levels.

With a sharp drop in interest rates from a high of 13.25% down to 7.0%, the secondary debt markets saw similar revaluations placing Fixed Income/ Money Market Funds firmly in the limelight due to generous revaluation gains.

Pakistan has fared relatively better than other countries in its Covid19 handling. Over 200,000 cases were confirmed in Pakistan till June 30, 2020 which was still a tiny percentage of the total global cases. The challenges however remain both on the fiscal and monetary planning side especially in sustaining economic normalcy in the face of a potential second wave.

Mutual Funds Update

Despite all the challenges, the mutual fund industry demonstrated operating and business resilience over the pandemic months. Total Mutual Fund Assets grew by 43% from PKR 540 bn in FY19 with Money Market schemes (both Conventional and Shariah Compliant) and Income schemes (both Conventional and Shariah Compliant) leading the overall growth with 41% and 23% respectively. The industry also saw an addition of 51,048 new investors over this time period taking total investor base up to 445,577 reflecting an overall growth of 13% in the underlying number of new accounts.

Product development also took center stage as in March 2020, two Exchange-Traded Fund (ETF)s were launched on the Pakistan Stock Exchange followed by two more in October 2020. The introduction of ETFs is a big leap for the Asset Management Industry and PSX as the product offers significant growth potential due to its transparent nature, low cost and embedded ability to track the index by following a passive investment strategy.

The industry shifted to remote working overnight as the lockdown was imposed towards end of March and it was very heartening to note a high level of cooperation between industry participants and the regulator in assuring uninterrupted business continuity over this time period.

The SECP further allowed specific relaxations to certain provisions of the Non Banking Finance Companies (NBFC) and Notified Entities Regulations 2008 and circulars to allow smooth operations.

As at June 30, 2020, there were 19 Asset Management Companies managing 300 funds including Open End, Exchange Traded Funds and Voluntary Pension Schemes while the asset under management (AUMS) of the mutual fund industry stood at PKR. 772.696 bn with PKR 741.869 bn in Open-End Funds, PKR 0.0868 bn in Exchange Traded Funds and PKR 30.740 bn in Pension Funds. During the year, the industry witnessed a launch of 30 new funds under Shariah Compliant Equity, Shariah Compliant Fund of Funds - Income, Shariah Compliant Fund of Funds - CPPI, Shariah Compliant Money Market, Shariah Compliant Capital Protected - Income, Shariah Compliant Aggressive Fixed Income, Fund of Funds, Fund of Funds - CPPI, Capital Protected, Capital Protected - Income, Money Market, Income, Asset Allocation and Exchange Traded Funds category. 18 funds matured and 2 were merged during the year.

Money Market Funds (both Conventional and Shariah Compliant) dominated the AUMs of the industry with the largest share of the mutual fund industry at 41 percent. Income (both Conventional and Shariah Compliant) held the second largest industry share at 23 percent, followed by Equity (both Conventional and Shariah Compliant) with industry share of 21 percent.

Board Review

The Board of MUFAP started its term on October 1, 2019 and aimed to bring to conclusion a number of outstanding matters both on the regulatory and taxation front that had been pending over a number of years. I am pleased to share that the Board,along with the proactive support from SECP,managed to conclude a number of matters as listed below.

Taxation

MUFAP proposal pertaining to the matter of the minimum tax on services rendered by Asset Management Companies was brought to a reduced rate of 3% under the Finance Bill 2021. The relevant amendment was made in Division III of Part III of First Schedule of Income Tax Ordinance 2001 through the Finance Act 2020 and the industry was grateful for the relief as provided on this front as it brought the tax in line with similar service industries.

Online Mutual Funds Distribution Platform MoU with the CDC

With the advent and growth of digital media over the years, there was a dire need for an online distribution platform for mutual funds. During the year, MUFAP and CDC (under the platform of its subsidiary IT Minds) initiated an MoU for development of an online distribution platform which would be used by member AMCs and would be a useful knowledge and transaction platform for existing and future investors.

The MOU between MUFAP and IT Minds was signed in October 2020 for Mutual Funds Distribution Platform (MFDP). With MUFAP acting as a knowledge partner on data and process flows and CDC/IT Minds responsible for the design and implementation of this online platform, we hope to create a one-of-its-kind fintech platform that would enhance investor outreach and bring transparency and operational efficiency to the transaction process.

The MFDP has been envisioned to use technology to provide a cost and time efficient solution under a convenient, informative and interactive medium for investors to invest in a wide range of investment products offered by different fund families. The proposed solution will completely digitalize the investor experience from on-boarding to transactions to portfolio tracking. This will be an attractive proposition to all investors, ultimately boosting the investor base and improving the overall performance of the mutual fund industry.

It is expected to be ready by end 2020 and will initially offer Sahulat Sarmayakari Accounts before transitioning to all fund account types.

MUFAP stands ready to support this mechanism and is ready to collaborate with other interested parties to introduce similar platforms which will help in the overall expansion of retail base of the industry.

Circular No. 02 of 2020 - Requirements for Assessing Suitability and Risk Categorization of CIS

MUFAP and SECP jointly worked to develop detailed guidelines for assessing customer suitability and standard risk categorization of collective investment schemes (CIS) to curb mis-selling of mutual fund products to investors. The guidelines have also standardized the risk categories of each category of funds and introduced appropriate risk profiles to help the investors easily understand and compare the risks associated with each category of funds. A number of detailed sessions were held with the MUFAP Board and with the SECP team with the final circular issued by the SECP on February 06, 2020. Subsequent to the issuance of the circular, MUFAP developed and issued guidelines with SECP's no objection to elaborate and explain the circular to help the industry implement the same in a standardized manner.

These developments are geared to help investors understand the underlying risk of their investments and to ensure the same are adequately disclosed and communicated.

SECP Policy Reforms for the Mutual Fund Industry

At the start of the year, Securities and Exchange Commission of Pakistan (SECP) and its Policy Board took the bold initiative to reduce the cost of doing business for investors in mutual funds via reduction in SECP fee levied on mutual fund investors. A number of other revamps were introduced in the NBFC regulatory environment to improve the ease of doing business. This pragmatic and progressive approach taken by the SECP resulted in resolution of many legacy issues and helped pave the way for sustained growth of the industry.

In the recent years, SECP has taken a number of steps to promote the development of mutual funds industry. These measures envisage multifaceted reforms to help the industry in managing its risks prudently, give operational autonomy, and reduce fragmentation as well as to protect investors' interest. Comprehensive disclosure requirements at the time of public offering and subsequent reporting on the affairs of funds have been prescribed and enforced. The steps taken by the Securities and Exchange Commission of Pakistan (SECP) to promote equity markets in general and mutual funds industry in particular are in line with overall macro-economic policies of the government and will help boost investment in mutual fund sector in years ahead.

Such reforms boosted growth significantly as the industry reported 43% growth even during the Covid19 pandemic. Branches and sales outreach were significantly enhanced and the industry responded positively by significant reductions in management fees on certain categories of funds which further boosted investor interest.

Non-Banking Finance Companies and Collective Investment Vehicles Act, 2020

SECP issued Draft Non-Banking Finance Companies and Collective Investment Vehicles Act, 2020. The Draft Act is a much needed modernized, dedicated and consolidated framework for the non-banking finance companies and collective investment vehicles (notified entities). MUFAP Board and Members had a detailed sessions on the same and presented and discussed our comments with the SECP in a detailed consultative session. We are hopeful that our points will be incorporated in the final draft.

Proposed Amendments in NBFC Regulations and VPS Rules

Consequent to the above mentioned draft NBFC & CIS Act, a number of amendments were introduced by the SECP in the NBFC Rules, NBFC Regulations and VPS Rules, shifting the operational details of VPS Funds from the VPS Rules into the NBFC Regulations. MUFAP Board reviewed and commented on the same. The amendments pertaining to VPS Rules are waiting to be notified by the relevant Ministry.

Proposal for investments in mutual funds through SCRA and Roshan Digital Accounts

MUFAP shared a proposal with the State Bank of Pakistan (SBP) with the consent of the SECP to allow investments in mutual funds through SCRA and Roshan Digital Accounts. The proposal included a detailed a process flow for investment in mutual funds from non-residents investors through SCRA accounts on a repatriation basis as well as the digital Roshan Accounts and proposed amendments in the Foreign Exchange Manual. The same is currently under review and discussion with the SBP and we are hopeful that this will be approved soon easing the process for investments in mutual funds and ETFs by Non Resident Pakistanis and Foreign Investors.

Investor Awareness Program

A key historical reason for the low retail investor base in Pakistan is lack of awareness among the general public of benefits of savings via mutual funds. Subsequent to the SECP fee reduction, MUFAP developed a mass scale investor awareness program to promote and market mutual funds. This plan was approved by MUFAP Board and shared with SECP to allow mandatory contribution of 2 basis points from the Mutual Funds towards funding this plan so the plan can run on a sustainable basis over the long term. The SECP asked MUFAP to keep it on a voluntary basis and MUFAP will now be relooking at its plan based on voluntary contributions.

Conversion to MUFAP into an SRO structure

During the year, the SECP asked MUFAP to share a phased wise plan to convert MUFAP into an SRO structure. MUFAP has shared a document for enhancing the r ole of MUFAP and a basic outline of activities which the SRO will undertake in a phased manner. To address the funding requirement for SRO operations, MUFAP has proposed that a 1bps fee be allowed to be charged to the funds. MUFAP's latest proposal and phase wise plan is currently under consideration at SECP. This will be a good step in the development of the industry.

Future outlook

A very different future is evolving post Covid19. A new norm of online and working from home has accelerated the development of the virtual economy. MUFAP will continue to strive for standards of excellence in the mutual fund industry and support member AMCs in their growth and expansion plans under these new operating realities.

MUFAP will also continue to play an active role in policy advocacy and reform working closely with the Regulator to identify future impediments to growth and work towards resolving the same. We will continue to promote market based saving mechanisms and market based best practices in the capital markets.

Acknowledgment

I would like to thank Ministry of Finance, the SECP and its Policy Board and Central Depositary Company of Pakistan Limited for their wonderful support throughout the year. I am particularly grateful to Dr Abdul Hafeez Shaikh, Finance Minister for his assistance and proactive stance towards the capital markets, Mr. Aamir Khan, SECP Chairman, Mr. Farrukh H Sabzwari, Commissioner SECP, Mr. Shauzab Ali Commissioner SECP, Ms. Khalida Habib, Executive Director SCD, Ms.Musarat Jabeen, Executive Director, Mr. Waseem Khan, Additional Director SECP and the entire AMCs and VPS teams at SECP for their proactive role in dealing with issues relating to the industry.

I would also like to thank my fellow board members, the Senior Vice Chairman Mr. Hasnain Raza Nensey, Vice Chairman Mr. M. Saqib Saleem, 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 in important matters.