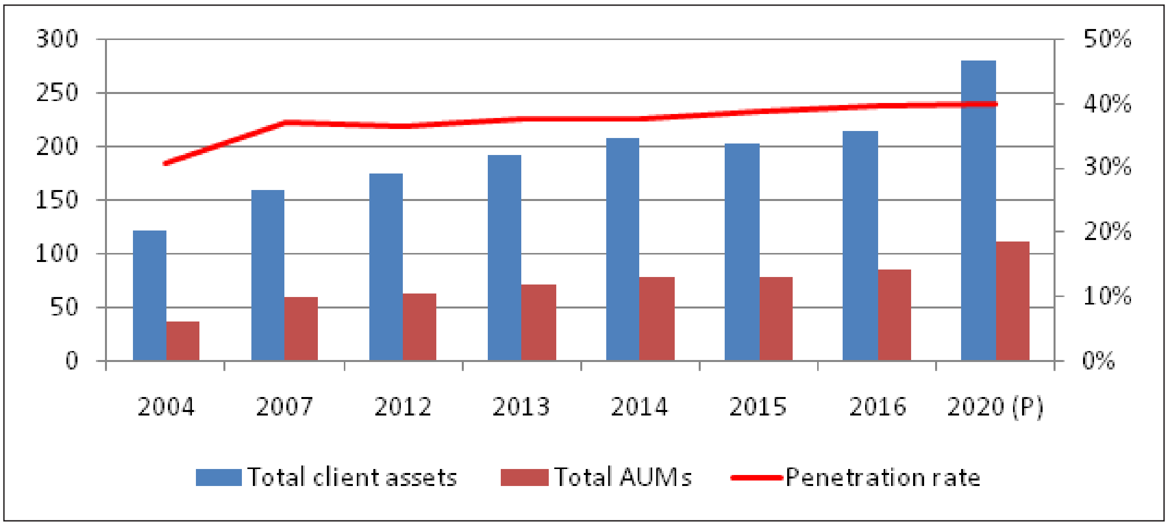
Asset Management Companies

June, 2018

Global Perspective

During the past decade, asset and wealth management industry has witnessed considerable growth globally on account of increase in quantum of investable assets, while penetration rate[1] has also remained healthy. Total value of investable assets amounted to USD 214.6 trillion at end-2016[2], while total Assets under Management (AUMs) accumulated to USD 84.9 trillion1, translating into penetration rate of 39.6%. Rise in the value of investable assets can be attributed to increasing integration across major economies, disintermediation of commercial banks due to limited growth avenues and disparity in savings and available investment opportunities. These trends are expected to persist in future as the projected quantum of total investable assets and AUMs are projected to increase to USD 279.3 trillion and USD 111.2 trillion, respectively by end-20201. The following chart depicts historical and projected growth trends.

Figure 1: Global growth trends[1]



Going forward, growth in AUMs in South American, Asian, African and Middle Eastern countries is expected to be higher than growth in AUMs in developed economies. The major reason behind this trend is due to vast majority of untapped avenues in these countries. However, given the substantial relative size of market of US and Europe in relation to these developing economies, concentration of assets is expected to remain within US and Europe. Growth in AUMs will continue to be driven by increasing wealth of high net worth individuals (HNWIs) along with increase in the size of pension funds and insurance vehicles.

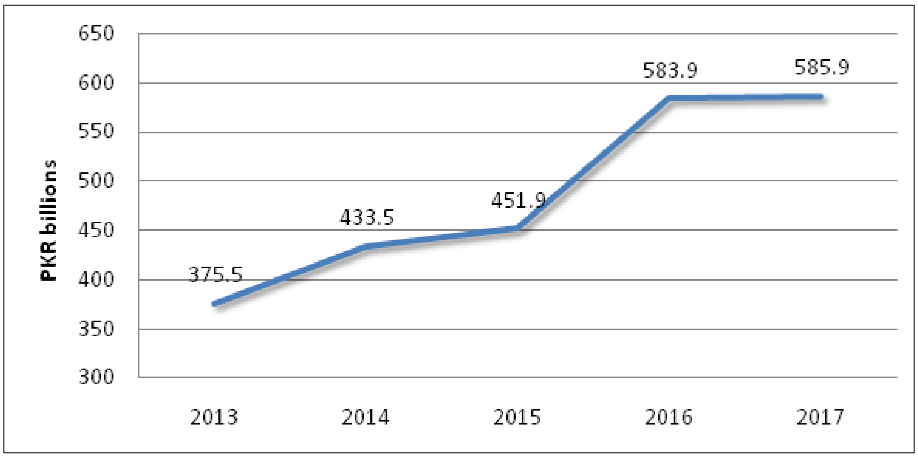
Local industry landscape[3]

Size and composition of AUMs

In line with the global trend, asset management industry in Pakistan has also depicted an upward trend as illustrated by the growth the AUMs (including open-end and closed-end mutual funds and voluntary pension schemes) of the industry. In the period 2013-2017, the total AUMs of the industry have grown at a Compound Annual Growth Rate (CAGR) of 11.8%. The following table indicates the quantum and growth trend in AUMs (net of FoF) of the domestic industry.

[1] Assets under management as a percentage of total investable assets
[2] PricewaterhouseCoopers : Asset & Wealth Management Revolution: Embracing Potential Change
[3] All the figures related to AUMs are quoted of net Fund-of-Fund (FoF) investments.

Figure 2: AUMs of local industry



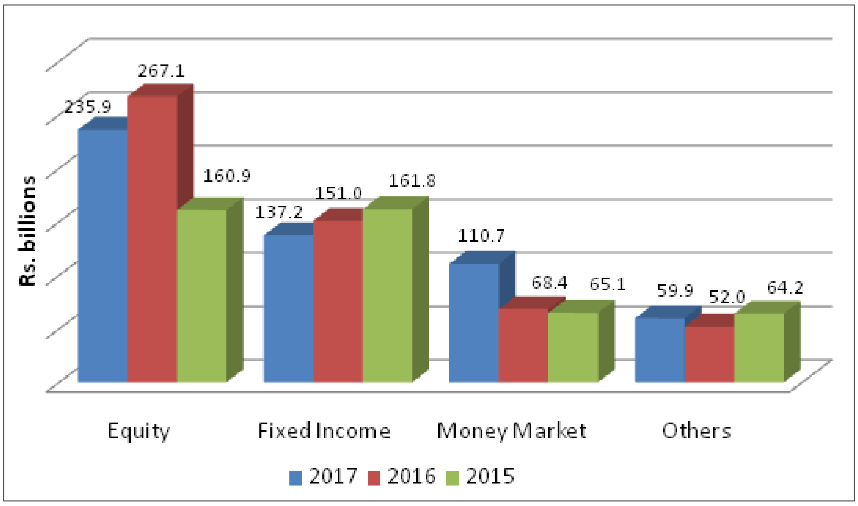
In terms of investment categories, majority AUMs of the industry are deployed in conventional funds, however, Shariah compliant funds share in the overall industry AUMs has increased over time. Given the investor preference for Shariah funds, asset management companies (AMC) have also started offering diversified products in this segment. Resultantly, the number of Shariah compliant funds in the industry has also grown. The following table indicates the composition of open-ended industry AUMs in terms of conventional and Shariah compliant funds:

Figure 3: Segregation of open-ended AUMs into Shariah compliant and conventional AUMs

(Rs. in billions)	2017			2016			2015		
Category	AUMs	Share	No. of funds	AUMs	Share	No. of funds	AUMs	Share	No. of funds
Conventional	328.3	60.4%	111	346.9	64.4%	107	305.7	72.9%	104
Shariah	215.4	39.6%	112	191.6	35.6%	86	113.9	27.1%	63
Total	**543.8**	**100.0%**	**223**	**538.5**	**100.0%**	**193**	**419.6**	**100.0%**	**167**

At end December 2017, total AUMs in open end equity funds decreased to Rs. 235.9b (2015: Rs. 267.1b; 2014: Rs. 160.9b) primarily on account of downturn witnessed in equity market performance during the second half of the year. Political uncertainty and weak macroeconomics in the country was the primary cause behind the downturn in the country. Due to low interest rates, substantial outflow was witnessed from the income funds category with majority of it transferred to low duration money market funds. This was mainly due to prevailing expectation of interest rates bottoming out. The following chart presents the fund category wise distribution of funds:

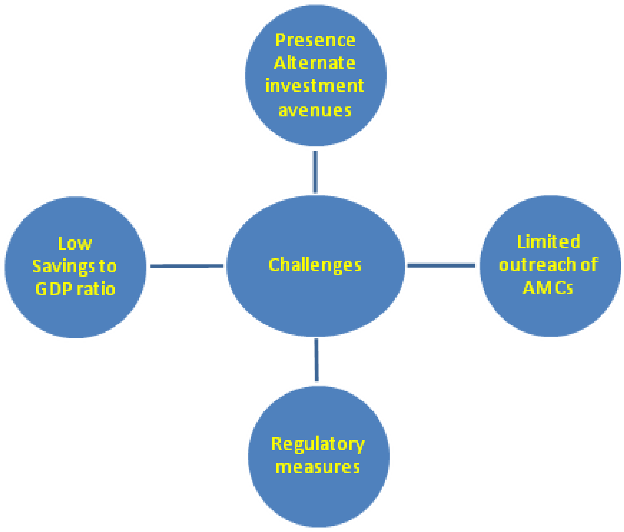
Figure 4: Open ended Fund wise constitution of AUMs



Industry structure
Consolidation has been witnessed in the asset management industry on a timeline basis in Pakistan. Large market players have opted to acquire smaller market players in order to increase their market share. In 2007, 76 funds were being managed by 29 AMCs, while only 20 AMCs were responsible for managing 223 funds in 2017. At end-2017, top 5 funds comprised 29% (2016: 33%; 2015: 30%) of industry's AUMs.

AUM profile
Institutional clients remain the primary source of investment in mutual funds in Pakistan; however, share of retail investors in overall AUMs has been gradually increasing over a period of time. At end-June 2017, retail investors accounted for 39% (end-Jun'16 : 40%; end-Jun'15: 35%; end-Jun'14: 25%) of industry AUMs. Lack of understanding of mutual funds is an issue hindering the growth in retail investor base. However, marketing initiatives undertaken by the AMCs, diversification in product portfolio and encouraging measures implemented by the regulator have made positive contribution in enhancing the retail base of the industry.

Challenges faced by the industry



Presence of Alternate Investment Avenues:
Given the lack of regulations pertaining to the real estate sector in Pakistan, and attractive returns offered by the same, real estate as an investment vehicle is a popular choice for investors. However, AMCs have been largely unsuccessful in tapping this alternative investment class. This has resulted in capital being accumulated in the real estate sector and therefore is not reflected in mutual fund's AUMs.

Represents a very attractive investment avenue for High Net Worth Individuals.
Since mutual funds provide indirect exposure to equity market and fixed income instruments, performance of equity market and upward movement in interest rates provide positive impetus for investment in mutual funds. In case of opposite scenario, real estate is an attractive alternate investment option for customers in Pakistan.

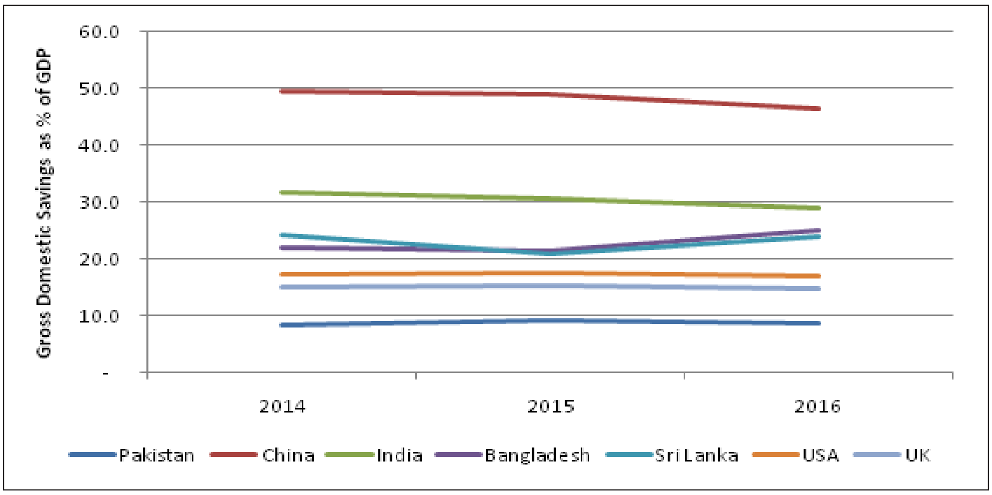
Limited outreach of AMCs:
Total AUMs of the mutual funds industry are around 4.5% of the total banking sector deposits in Pakistan as at December 2017, thereby signifying a vastly untapped market and considerable potential for growth in AUMs. However, as per industry experts, the branch network of AMCs is limited to capture the potential growth. Moreover, majority of the branches of the AMCs are concentrated in urban cities while a sizeable proportion of Pakistan's population is based in rural areas. Hence, importance of creating awareness about mutual funds industry to rural population cannot be understated. Realizing this issue, the regulator, Securities and Exchange Commission of Pakistan, has issued a circular which allows open-end equity, asset allocation and index funds to charge up to a maximum of 0.4% per annum of net assets of fund or actual expenses whichever is lower as Selling and Marketing Expenses. However, provision for such selling and marketing expenses is allowed only to those AMCs that will open new branches in cities other than Karachi, Lahore, Islamabad and Rawalpindi as per a specified schedule. Measures such as these will go a long way in increasing penetration in the retail sector.

Regulatory measures:
Adverse regulatory measures continue to remain a persistent risk for the industry. In the past, the industry has been subjected to super tax for different purposes and Federal Excise Duty (FED), which was essentially a double tax on the investors who were already subject to provincial sales tax on services at 13%. Although the industry initially managed to obtain stays from courts against such measures and eventually these taxes were abolished by the courts, AMCs incur increase in expense base due to legal fees. Furthermore, regulations such as mandatory acquisition of income tax exemption certificates by all recognized provident, superannuation and gratuity funds also create operational inefficiencies for AMCs.

Low Savings to GDP ratio:
Savings are a prerequisite for investment in mutual funds, while Pakistan's economy can be characterized as consumption based economy as gross domestic savings to GDP ratio of Pakistan has remained below 10% in the period from 2010 to 2016[4]. In terms of savings, Pakistan lags behind not only well developed economies but also its regional peers as indicated in the following chart.

[4] *Source: World Bank*

Figure 5: Gross domestic savings to GDP ratio[3]



Future Outlook

Growth in industry AUMs is contingent upon creation of a favorable regulatory environment for the industry along with efforts on the part of AMCs to undertake measures to create awareness about mutual funds and increase retail penetration.

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