SECP

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

CONSULTATION PAPER

“Mutual Fund for Masses”

Rethinking the Mutual and Pension Fund's Expense Regime (TER)

&

Distribution Model Paradigm

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Section - A
Mutual Funds

Objective of the Section - A

Mutual Fund for Masses – Transforming and simplifying the Expense Regime for Transparency, Enhanced Disclosure and Cost Efficiency to Boost Retail Access.

In an effort to make mutual funds more accessible and beneficial to a broader population, this consultation paper aims to evaluate and improve the Total Expense Ratio (TER) of mutual funds, focusing on Management Fees and Permissible Expenses. By seeking feedback and suggestions, we aim to lower the financial burden on unit holders and enhance retail penetration. This proposal is based on international best practices and strives to foster stronger savings habits promoting mutual funds as reliable investment opportunities, and capital mobilization at the grassroots level.

In pursuit of refining the regulatory landscape for mutual funds, this paper explores how current industry practices align with evolving market trends and investor needs. The review will encompass an analysis of the existing Total Expense Ratio (TER) in comparison to global standards; aiming to bolster clarity and safeguard investor interests. By emphasizing a more transparent and optimized fee structure framework, the goal is to facilitate a more inclusive and efficient investment environment, ultimately driving greater interest from retail investors and supporting sustained economic growth.

Understanding Total Expense Ratio Requirements in the Mutual/Pension Fund Regulatory Framework

The "Total Expense Ratio" is the sum of all the daily expenses borne by the fund divided by the average daily asset value which is transferred to the unit holders/participants proportionate to their respective investment in the fund. These expenses encompass all the fees (like Management Fee, Trustee Fee, and regulatory Fee), expenses, taxes, and government charges incurred from the fund.
Note: Sales load is not part of TER.

Specified Caps on TER: The current regulatory framework sets specific regulatory caps for the Total Expense Ratio (TER) for each category of Mutual Fund/Pension Fund.

Permissible Expenses: The list of permissible expenses for Mutual Funds and Pension Funds are attached as **Annexure A & B.**

Calculation of TER in accordance with Specified Caps: Currently, the costs incurred in relation to any government levy on funds such as sales tax, Worker's Welfare Fund or regulatory fee etc. are excluded for the calculation of TER against specified regulatory caps for Mutual and Pension Funds.

Disclosure of TER: Asset Management Companies and Pension Fund Managers are required to disclose the TER for Mutual Funds in FMR in two forms i.e. TER including levies and TER excluding levies.

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1. Objective of this section is:

Review of currently Applicable Regulatory Cap on TER	**Review of Currently Allowed Expenses**
Proposed Optimization of Management Fee Cap	**Proposed Additional Disclosures in FMR**

2. History of TER, Management Fee, S&M Expenses for Mutual Funds

1. **Management Fee Cap:** Management Fee was initially capped at 2-3% irrespective of Fund Category. In 2015, with the introduction of total expense ratio, fund wise Management Fee cap was introduced ranging from 1%-2%. However, Management Fee capping was removed in 2019 and the overall cap on expense ratio continued.
2. **TER Cap**: In 2015, along with Management Fee Cap, the concept of TER Cap was also introduced for respective categories of Mutual Funds ranging from 2% to 4% for initial 3 years. Later on, in 2019, the cap on management fee was removed and TER for Equity Funds was enhanced to 4.5% and for Income Funds to 2.5%.
3. **Selling and Marketing Expenses:** In 2017, Selling and Marketing Expenses were initially introduced and capped for limited funds i.e. Equity, asset allocation and index fund. However, in 2019, Selling and Marketing expenses were permitted for all fund categories without any regulatory cap, within the specified caps for TER.

3. Currently Allowed TER Caps for Mutual Funds

Currently, following maximum chargeable TER caps for Mutual Funds are specified excluding any government levy and regulatory fee etc.

Mutual Funds Category	Allowed TER
Equity Balanced, Asset Allocation and capital protected (dynamic asset allocation-direct exposure) Schemes	4.5%
Money Market	2.0%
Income, aggressive income, Capital protected, Index and Commodity Schemes (cash settles)	2.5%
Commodity Schemes (deliverable)	3.0%
Fund of Fund	2.5% if MF charged and 0.5% otherwise

4. Overview of Total Expense Ratio Charged for Mutual Funds

Comparative of the current TERs being charged by the AMCs for Mutual Funds (consolidated into four broader categories) spanning over a period of last three years is as below:

Mutual Funds Categories	FY - 2024 (Jul-Mar 24)*				FY - 2023**				FY - 2022**			
	TER	MF	S&M	Other Exp	TER	MF	S&M	Other Exp	TER	MF	S&M	Other Exp
Fixed Income	1.70%	0.92%	0.23%	0.55%	1.17%	0.57%	0.37%	0.23%	1.11%	0.54%	0.33%	0.24%
Equity & Balanced	3.74%	1.80%	0.56%	1.38%	3.48%	1.82%	1.10%	0.56%	3.36%	1.78%	1.16%	0.42%
Money Market & Fixed Rate	0.82%	0.42%	0.13%	0.27%	0.85%	0.44%	0.22%	0.19%	0.49%	0.25%	0.10%	0.14%
ETF	1.71%	0.43%	0.43%	0.85%	1.38%	0.39%	0.00%	0.99%	1.60%	0.43%	0.00%	1.17%
*Source: MUFAP (TER adjusted, excluding regulatory Fee, Gov. Levies/taxes)					**Source: SECP							

The above stated data reflects that market competition caused the AMCs to keep the overall TER below the allowable caps.

5. Areas for Consideration

5.1 <u>Varying rate of Management Fee:</u> During the market study, it has been observed that AMCs often apply varying rates of management fee rather than a fixed rate on a daily basis. Instead of specifying a definite rate, some AMCs use a range such as **"up to x%"** for the management fee in the offering document. This approach is frequently utilized as a strategy to optimize competitive returns, particularly within the money market and fixed return segments.

5.2 <u>Selling and Marketing Expenses:</u>

The inclusion of selling and marketing expenses under the permissible expenses to be charged to the funds while adhering to the specified regulatory caps of TER was originally intended to stimulate equity market expansion and retail investor participation by encouraging AMC's to expand their branch network. However, an analysis of market trends and industry data reveals the following observations:

a. <u>Industry Growth and decline in Retail Investors:</u>

- AMC industry grew from PKR 500 billion to PKR 2.0 trillion (2019 to Dec 2023) largely due to the money market and fixed income segments influenced by high interest rates.
- Despite overall growth in AMC industry, retail investors' holdings reduced from 40% to 38% during the same period.

b. <u>Asset Allocation Trends for the Mutual Funds:</u>

- 48% of AUMs placed as deposits with Banks & DFIs.
- Investment by Mutual Funds in government debt securities grew from PKR 51 billion in 2019 to PKR 604 billion by Dec 2023.

PKR Million

Period	Investment in Government Securities	Investment in Debt Securities	Deposit with F.I and Cash with Bank	Total Assets
June 30, 2022	51,090	84,836	860,283	1,021,068
June 30, 2023	515,138	91,829	746,777	1,443,763
Dec 31, 2023	604,962	102,456	1,075,887	2,231,812

c. Decline in Equity Funds

Share of stock market linked equity funds dropped significantly from 40% in 2019 to only 10% in 2023. It is important to note that despite charging highest Selling and Marketing Expenses as part of their Total Expense Ratio, the stock market linked Mutual Funds could not attract new investors.

d. Impact of Selling and Marketing Expenses:

- Overburdening existing investors.
- Perceived as taxing existing investors to attract new ones.

6. International Jurisdictions

As per the Morningstar Global Investor Experience Study Report 2022, average TER among 26 countries for Fixed Income, Equity and Asset Allocation Category remains as under:

1. Fixed Income – 0.66%
2. Asset Allocation – 1.25%; and
3. Equity Scheme – 1.41%.

The average TERs reported are as follows:

Country	Fixed Income	Equity	Asset Allocation
China	**0.46%**	**1.75%**	**1.76%**
Thailand	**0.42%**	**1.46%**	**1.24%**
USA	**0.43%**	**0.63%**	**0.58%**

It is apparent from the Morningstar Global Investor Experience Study Report, 2022 that average TER among 26 countries are relatively lower compared to those in Pakistan. Globally, the average TER is 0.66% for Fixed Income, 1.25% for Asset Allocation, and 1.41% for Equity schemes. In contrast, the mutual fund industry in Pakistan has significantly higher TERs, with Fixed Income TER exceeding 1.5%, Equity and Asset Allocation TERs surpassing 3.5%, and Money Market TER at 0.82%. This disparity indicates that investors in Pakistan face relatively higher costs compared to international standards, potentially impacting the overall attractiveness and competitiveness of Pakistan's mutual fund industry.

7. Proposal/Recommendations Regarding TER Regime for Mutual Funds

1. Withdrawal of Specified Regulatory Caps for TER	**2. Revival of Management Fee Capping**
3. Revised and exhaustive List of chargeable Expenses for Mutual Funds for clear disclosure	**4. Additional Disclosures in FMR and disclosure of all-inclusive TER**

7.1 Withdrawal of TER Cap and Introduction of Management Fee Cap:

The proposed amendment in the regulatory framework entails the withdrawal of the TER cap and its substitution with a cap on Management Fees (inclusive of applicable taxes), with Exhaustive List of Chargeable Expenses including regulatory Fee:

Category of Mutual Funds	Proposed Management Fee Caps
Money Market	0.50% p.a.
Income, Aggressive Income, Capital Protected, Index and Commodity Schemes (cash settled)	1.00% p.a.
Balanced, Capital Protected (Dynamic Asset Allocation – Director Exposure) and Commodity Schemes (Deliverable)	1.50% p.a.
Equity Schemes, Asset Allocation	2.00% p.a.
Fixed Rate/Return Scheme	0.50% p.a.
Exchange Traded Fund	0.50% p.a.
Fund of Fund	0.50% p.a.

Desired Impact: *The proposal aims to protect the interests of unitholders by imposing caps on AMCs fee to prevent exploitation.*

7.2 Revised list of chargeable expenses for the Mutual Funds:

Withdrawal of permission for charging following expenses:

- Fees and expenses related to registrar services, accounting, operation and valuation services related to Mutual Funds whether inhouse or outsourced;
- Printing costs and related expenses for issuing the quarterly, half-yearly and annual reports, etcetera of the Mutual Funds; and
- Selling and Marketing Expense, Advertising and Publicity expense & expense for development of alternate delivery/distribution channels.
- Introduction of **Market Development Charges** in certain categories of Mutual Funds to promote distribution and awareness of Mutual Funds.

Desirable Impact: *The proposal targets to rationalize chargeable expenses and avoid any varying/extended interpretation of the same by the regulated entities. While beinging clarity for the investors for transparency.*

7.3 Additional disclosure in Fund Manager Report (FMR):

AMCs shall ensure complete disclosure of all expenses in the FMR segregated under respective expense heads; including but not limited to Management Fee, Trustee Fee, Regulatory Fee and Other Expenses as well as Government Taxes/Levies.

The following additional mandatory disclosure shall be made in the FMR;

- Portfolio turnover frequency in the fund.
- Disclosure of TER (YTD/MTD) shall be made as per the following format:

M.F	Regulatory Fee	Trustee Fee	Levies and Taxes	Other Expenses	Total TER with levies	Total TER without leviee
a %	b %	c %	d %	e %	(a+b+c+d+e)%	(a+b+c+e)%

Desired Impact: *The proposal aims to enhance transparency to unitholders.*

Annexure. A

Expenses Chargeable to Mutual Funds

Expenses Chargeable to Mutual Funds	Expenses directly Chargeable to Investors
1. Registration of Fund 2. Formation Cost 3. AMC Fee 4. Selling and Marketing Expenses 5. Registrar, Accounting, Operation, Valuation Services 6. Regulatory Fee 7. Expenses Charged by Trustee 8. Trustee Fee 9. Other Exp*	1. Sales Load 2. Contingent Load 3. Transaction Charges (1-link, Quick pay etc)

***Other expenses chargeable to mutual funds are as follows:**

Fixed	Transaction
1. Listing fee to the stock exchange and its Renewals; 2. Shariah advisory fee; 3. Rating fee payable to approved rating agency; 4. Auditors' fees and their out of pocket expenses; 5. Expenses incurred by trustee in affecting registration of all registerable assets in the name of the trustee; 6. Legal and related costs incurred in protecting the interests of the unit, certificate or shareholders of the Collective Investment Scheme;	1. Charges and levies of PSX, NCCPL and CDC; 2. Brokerage and transaction costs related to investing and disinvesting of the assets of the Collective Investment Schemes; 3. hedging costs including forward cover, forward purchase or option purchase costs; 4. Bank charges, borrowing and financial costs; 5. Printing costs and related expenses for issuing the quarterly, half-yearly and annual reports, etcetera of the Collective Investment Scheme; 6. Taxes, fees, duties and other charges applicable to the Collective Investment Scheme on its income or its properties, including taxes, fees, duties and other charges levied by a foreign jurisdiction on investments made oversees; and 7. Custody and insurances costs relating to the safekeeping of the physical gold in the vault(s) for Commodity Funds.

Section - B
Pension Funds

Objective of the Section - B

This section is focused towards seeking feedback and suggestions on:

- Evaluation of the Total Expense Ratio Regime, encompassing the Management Fee and Permissible Expenses for the Pension Funds; and
- Proposed recommendations for requisite changes in the expense regime for the Pension Funds aimed at improving reducing cost for participants on their long-term post-retirement benefits, based on international best practices.

The objective of this section is to evaluate and propose amendments to the total expense regime for the Pension Funds with the aim of reducing the financial burden on pension fund participants and enhancing their returns for long-term post-retirement benefits. By reviewing and recommending changes to the Total Expense Ratio (TER), which includes Management Fees and Permissible Expenses, the paper seeks to reduce costs for participants in line with the international best practices to ensure that participants receive maximum value from their pension savings, ultimately contributing to a more secure and prosperous retirement.

Additionally, this paper underscores the importance of the defined contribution model under Voluntary Pension Funds, which must offer lower costs and competitive returns to its participants. The concept note aims to ascertain whether changes are needed in the current regulatory framework to ensure that pension fund participants are not overcharged while receiving competitive returns. This approach is essential for enhancing transparency, investor protection, and broader retail penetration. By evaluating and potentially reforming the regulatory framework, we aim to create a more efficient and equitable system that better serves the retirement needs of all participants.

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1. Objective of this concept paper is:

Reinforcing the Current Concept of "TER" to Reduce Costs for Long-Term Savings.	**Simplifying the overall expense framework for Pension Funds.**

2. History of TER, Management Fee, Selling and Market Expenses for Pension Funds

I. **Management Fee:** Management Fee cap of 1.5% was initially applicable to Pension Funds prior to 2021, which was discontinued when TER caps were introduced in 2021.

II. TER Cap: The concept of a TER Cap was introduced in 2021 for pension funds, similar to its implementation for Mutual Funds.

III. Selling and Marketing Expenses: Pension Funds were allowed to charge Selling & Marketing expenses in 2021, prior to that no Selling and Marketing expenses were allowed to be charged to pension funds. The permission was rescinded again in February 2024.

3. Currently Allowed TER Caps for Pension Funds

Currently, following maximum chargeable TER caps for pension funds are specified excluding any government levy and regulatory fee etc:

Pension Sub-Fund Category	Allowed TER
Equity Sub Fund	4.5%
Money Market Sub Fund	2.0%
Income, Commodity Fund	2.5%

4. Overview of Total Expense Ratio Charged for Pension Funds

Comparative of the current TERs being charged by the Pension Fund Managers (PFMs) for pension funds (consolidated into four broader categories) over a period of last three years is as below:

Pension Sub-Funds Categories	FY - 2024 (Jul-Mar 24)*				FY - 2023**				FY - 2022**			
	TER	MF	S&M	Other Exp	TER	MF	S&M	Other Exp	TER	MF	S&M	Other Exp
Income Sub-Fund	1.36%	0.87%	0.03%	0.46%	1.57%	0.61%	0.14%	0.82%	1.85%	1.15%	0.42%	0.59%
Equity Sub-Fund	2.86%	1.50%	0.18%	1.17%	3.31%	1.68%	0.48%	1.15%	2.84%	1.66%	1.44%	0.87%
Money Market Sub-Fund	1.11%	0.68%	0.03%	0.40%	1.15%	0.49%	0.16%	0.50%	1.59%	1.03%	0.37%	0.46%
Commodity Sub-Fund	2.37%	1.21%	0.01%	1.14%	2.06%	1.03%	0.00%	1.03%	2.13%	1.07%	-	1.06%
***Source: MUFAP (TER adjusted, excluding regulatory Fee, Gov. Levies/taxes)**					****Source: SECP**							

It's worth mentioning that while market competition has compelled PFMs to maintain the TER within specified regulatory bounds, there's a disparity where investors' long-term savings are subjected to considerably higher charges, similar to the TERs for Mutual Funds. Pension funds, being long-term passive investments are not exposed to liquidity risk and these pension funds do not require the active management by pension fund managers. Therefore, higher TERs, similar to those for mutual funds, place an extra burden on participants.

5. International Jurisdictions:

With regards to evaluation of applicable management fee as per OECD Report- Pension Markets in Focus 2020, it appears that the management fee ranges between a minimum of 0.5% to a maximum of 5% among 41 countries.

There is an increasing trend by several OECD jurisdictions to place lower caps on management fees charged to TEIR-II pension schemes.

6. Proposal/Recommendations Regarding TER Regime for Pension Funds:

Introduction of revised TER Caps for Pension Funds	Introduction of an Exhaustive List of Chargeable Expenses for the Pension Funds

6.1 Introduction of an Exhaustive List of Chargeable Expenses for the Pension Fund:

Allowance of only following head of expenses to be chargeable to pension funds:

1. Remuneration of pension fund manager;
2. Remuneration of trustee;
3. Regulatory fee; 4.
 Amortization of formation cost;
5. Safe custody and bank charges;
6. Market Development Charges equivalent to
 0.010%;
7. Auditor's remuneration;
8. Borrowing expenses;
9. Legal and other professional fees,
10. Brokerage and transaction cost
11. Shariah advisory fee; and
12. Custody charges.

6.2 Introduction of revised TER framework for Pension

Category of PF	Proposed TER Caps
Money Market Sub Fund	1.00% p.a.
Income, Commodity Sub Fund	1.00% p.a.
Equity Sub Fund (Active)	2.00% p.a.
Equity Index Sub-Fund (Passive)	1.00% p.a.

The above mentioned TERs shall encompass all expenses excluding regulatory fee and government levy on funds (such as sales tax, worker's welfare fund).
Desired Impact: *The proposal to adjust the TER downwards, while upholding an overall cap on TER, is aimed at effectively managing the total costs being borne by investors upon their long-term savings endeavors.*

6.2.1. Reasons for imposing a lower TER for Pension Funds:

I. **Investment Strategy:** Pension funds typically have long-term investment horizons, allowing them to invest in lower-cost, stable assets. This can reduce the overall expense ratio compared to funds that require more active management.

II. Lower Transaction Costs: With a longer investment horizon, pension funds engage in fewer transactions, thereby incurring lower transaction costs compared to actively managed funds with frequent trading.

III. Lower Marketing Costs: Unlike retail investment products, pension funds do not need to spend heavily on marketing and distribution, which can lower overall expenses.

Annexure. B
Expenses Chargeable to Pension Funds

Expenses Chargeable to Pension Funds	Expenses directly Chargeable to Investors
1. Authorization of Fund 2. Management Fee/Remuneration of the Pension Fund Manager 3.Formation Cost 4. Registrar, Accounting, Operation, Valuation Services. 5. Regulatory Annual Fee. 6. Expenses Charged by Trustee 7. Trustee Fee 8. Other Exp*	1. Sales Load 2. Transaction Charges (1-link, Quick pay etc)

***Other expenses chargeable to pension funds are as follows:**

Fixed	Transaction
1. Listing fee to the stock exchange and its Renewals; 2. Shariah advisory fee; 3. Rating fee payable to approved rating agency; 4. Auditors' fees and their out of pocket expenses; 5. Expenses incurred by trustee in affecting registration of all registerable assets in the name of the trustee; 6. Legal and related costs incurred in protecting the interests of the unit, certificate or participants of the Pension Fund;	1. Charges and levies of PSX, NCCPL and CDC; 2. Brokerage and transaction costs related to investing and disinvesting of the assets of the Pension Fund; 3. hedging costs including forward cover, forward purchase or option purchase costs; 4. Bank charges, borrowing and financial costs; 5. Printing costs and related expenses for issuing the quarterly, half-yearly and annual reports, etcetera of the Pension Fund; 6. Taxes, fees, duties and other charges applicable to the Collective Investment Scheme on its income or its properties, including taxes, fees, duties and other charges levied by a foreign jurisdiction on investments made oversees; and 7. Custody and insurances costs relating to the safekeeping of the physical gold in the vault(s) for Commodity Funds.

Section - C
Distribution Model Paradigm for the AMC/PFM Industry

Objective of the Section - C

This section evaluates the existing regulatory and compensation structures for Distributors within the mutual fund and pension fund industries. The primary objective is to examine the current practices on investment cost disclosures, such as front-end loads, and their impact on investors. Additionally, the study will investigate the reasons behind the stagnation in the distribution industry, including the sector's sole dependency on asset management companies' in-house sales teams and transparency issues related to the non-disclosure of distributor compensation through management fee sharing.

To address these challenges, this section explores several potential changes aimed at making distributor compensation more attractive and transparent. This includes eliminating sales loads, such as front-end loads, and introducing more practical concept of onboarding charges. It is also envisioned to implement transaction charges on new investments, providing additional commissions for distributors in cities other than the leading urban clusters (tier-2 cities), and introducing trailing commission accrual. These measures foster a more dynamic and independent distribution sector with deeper penetration both demographically as well as geographically.

Furthermore, this section will explore the introduction of market development charges to pool funds for investor education. This initiative aims to enhance retail penetration and promote saving habits among households and businesses in both formal and informal sectors. By tackling these issues, the Securities and Exchange Commission of Pakistan seeks to build a more robust distribution industry that supports economic growth and encourages a culture of saving across diverse segments of the population.

A distributor is a person authorized on behalf of an asset management company or a pension fund manager to sale the collective investment schemes and/or the pension funds to the prospective investors/ participants against a defined commision/fee/charges.

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1. Objective of this concept paper is:

Encouraging independent distributors to supplement efforts in expanding outreach of Mutual Fund/Pension Funds based savings	**Defining optimal fee structure for investors, onboarding and investment AMC's Remuneration and incentives for the Distributors(Investment Advisors)**

2. Overview of Front-End Load Charged to Investors During last Three Years

Front-End Load Charged (Data sources from AMCs)	FY – 2021		FY – 2022		FY – 2023	
	Rs. Million	**%**	**Rs. Million**	**%**	**Rs. Million**	**%**
Individual – Direct	511.79	93%	590.51	96%	793.28	92%
Corporate – Direct	37.49	7%	21.50	4%	64.46	8%
Total Direct	**549.29**	**72%**	**612.02**	**68%**	**857.75**	**58%**
Individual – Distributor	194.14	90%	284.31	97%	587.96	96%
Corporate – Distributor	20.62	10%	8.78	3%	27.34	4%
Total Distributor	**214.7**	**28%**	**293.10**	**32%**	**615.31**	**42%**
Grand Total	**764.06**	**100%**	**905.12**	**100%**	**1473.06**	**100%**

Across the industry, main source of new investments remains to be the direct sales by AMCs i.e. 58%. Major quantum of front-end load is charged in case of Individual investors while corporates enjoy immunity (presumably on the basis of negotiating power with higher ticket size). Moreover, no front-end load has been charged for around 83% of the new investments received during FY-2023.

3. Study of International Jurisdictions:

3.1. Comparative Study of Internationally Applicable Front-End Load Regime:

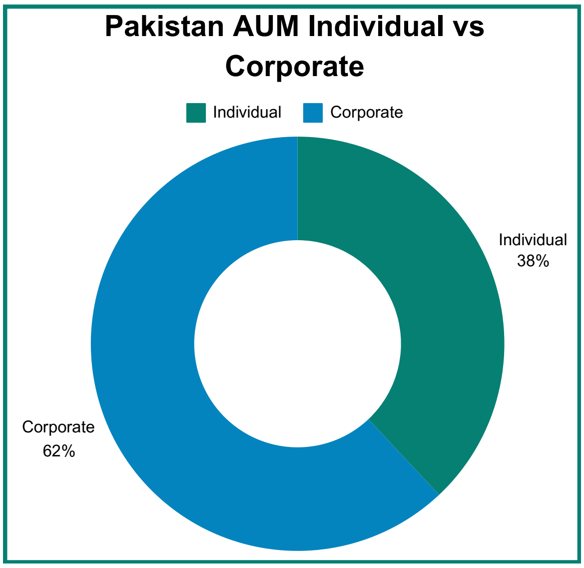
Country	Front-End Load	
	Permission to Charge	**Regulatory Caps**
Malaysia	Yes	No Cap
Singapore	Yes	Up to 5%
USA	Yes	No Cap by SEC FINRA Caps Sales Load to up to 8.5%
Canada	Yes	Up to 5%
India	**For Direct Investment** = No Front-End Load **Investment through Distributor** = Yes	**Existing Investor** = Rs. 100/- for min. transaction ≥ Rs. 10,000/- **New Investor** = Rs. 150/- as transaction charges. For SIP, transaction charge is applicable if the total commitment recoverable in instalments is >10,000/-.
Pakistan	Yes	3% of Investment

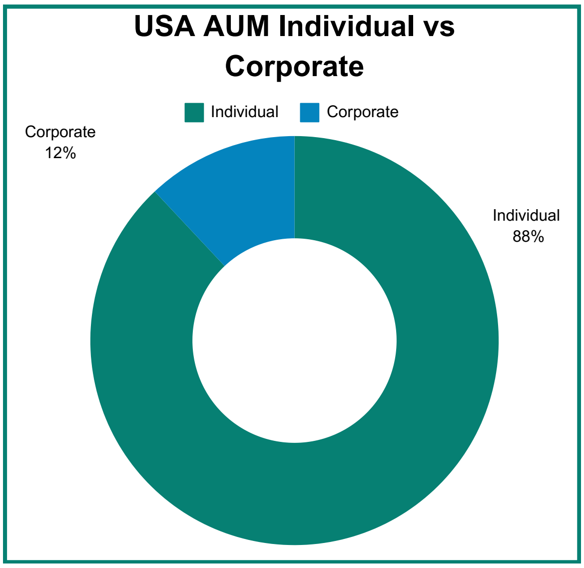
3.2. MUTUAL FUND Participants in International Jurisdictions

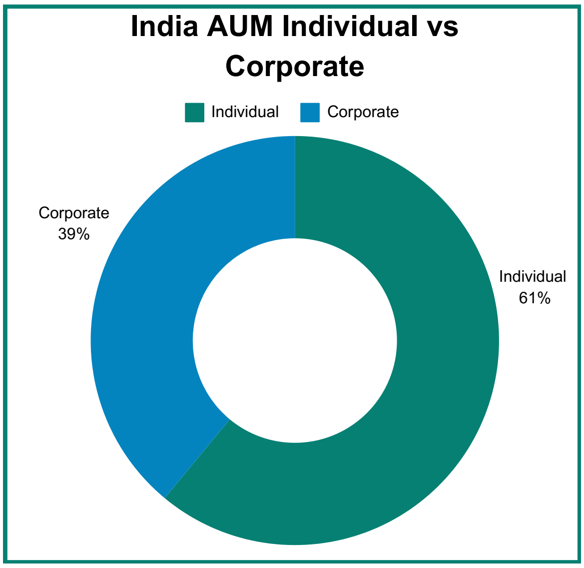
The mutual fund industry has witnessed rapid expansion, propelled by factors such as regulatory reforms, heightened investor awareness, and the popularity of systematic investment plans (SIPs) in neighboring jurisdiction. The retail penetration there, has notably increased, with a broadening investor base that extends beyond metropolitan areas.

USA- Retail penetration in the USA is substantial, reflecting a high level of individual investor participation in mutual funds as part of their investment portfolios.

Following is a synopsis of two jurisdictions i.e. USA and neighboring jurisdiction, compared to investor segmentation in Pakistan:

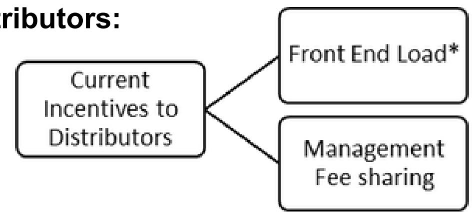






4. Areas for Consideration:

4.1. Under-Compensation of Distributors:



*Majority of sales are through AMC, hence a very negligible share of FEL is captured by distributor

4.2. Disclosure on Investment Costs- Lack of transparency on upfront deductions like Front-End Load (FEL).and impact on overall investment returns not adequately disclosed.

4.3. Limited Outreach- Lack of growth in the distributor induced sales of MUTUAL FUND products. AMCs reliance on own sales force caused limited outreach. The market is literally devoid of any white label products, product bundling and cross selling.

4.4. Transparency Issues- Lack of disclosure/transparency/standardization of compensation framework offered by AMCs to the distributors in the form of %age sharing of FEL and trailing commissions in the form of management fee %age sharing. This triggered investment advice driven by revenue consideration of the distributor rather than the best interest of the investors.

5. Proposal regarding Distribution Model for MUTUAL FUND and PENSION FUND Products

1.Exclusion of the concept of sales load	**2. One-time Onboarding Charges**	**3. Transaction Charges on New Investments**
4. Additional Charges for Non-Tier I Cities	**5. Management Fee Sharing Disclosure**	**6. Trailing Commission Accrual and Distribution**
7. Ban on Re-tagging of Investors	**8. Introduction of Market Development Charges**	

5.1. Withdrawal of the concept of Sales Load: Restriction of charging any types of Sales Load by the AMCs, PFMs and/or Distributors from investors of the MUTUAL FUND and PENSION FUND, with the only exception of charging compensatory contingent load in case of redemption from specific MUTUAL FUND (only) category which shall become part of the trust property;

5.2. One-time Onboarding Charges: AMCs/PFMs and Distributors shall be allowed to receive or recover one-time onboarding charges from the new investors of MUTUAL FUND and Participants of PENSION FUND at a rate of Rs. 150/- for each new investor;

Desired Impact: *to separate the process of On-Boarding from the investment process and encourage penetration of independents on-boarding platform which should be used by distributors (without engaging with any AMC/PFM). It also allows the AMC and/or the distributor to pass on the on-boarding cost or continue with the current practice to absorb the same.*

5.3. Transaction Charges on New Investments: Distributors (only) shall be allowed to recover transaction charges of Rs.150/- from new investors and Rs.100/- from existing investors on all new investment transactions in MUTUAL FUND exceeding Rs. 25,000/-. Such charges shall not be applicable in case PENSION FUND.

Desired Impact: *Encouraging outreach to new investors*

5.4. Additional Commission for Non-Tier I Cities: Distributors (only) shall be allowed to recover additional charges for Rs. 50/- from new investors emanating from cities other than Tier I cities (list of be notified by MUFAP in consultation and with approval of SECP) with a clear disclosure in the account statement of the respective investors in terms of city name and additional fee charged.

Desired Impact: *Encouraging engagement with new retail clients in cities beyond easy to access tier I cities.*

5.5. Management Fee Sharing Disclosure: Allowance of sharing management fee by the AMC/PFM with Distributors with a clear disclosure of %age (exact %age and not with a qualification of up to or not exceeding) of sharing in respect of each distributor for each category of the scheme on its website.

Desired Impact: *Incentive structure of the distributor/Investment Advisor offered by AMC should be clearly known to the market/investor to discourage any discriminatory practices/ fee arbitrage (positive or negative) against other distributors.*

5.6. Trailing Commission Accrual and Distribution: Allowing AMCs to accrue on a daily basis on behalf of the distributors, an additional 0.25% in case of Equity, Asset Allocation, and Balanced Schemes and 0.10% in all other Schemes excluding ETF and Fund of Fund; as trailing commission which shall be credited to the distributors account in the form of issuance of new units of any of the schemes of his choice with the AMC (both in case of MUTUAL FUND and PENSION FUND).

Such commission shall be charged as part of the NAV to the net assets of that specific class of units under particular scheme which shall be issued to investors/investments emanating from distribution channels. The AMC may issue a separate class of units to cater to this structure and 100% of such amount shall be passed on to the distributor subject to applicable taxes (if any).

Desired Impact: *This proposal is to ensure a minimum incentive mechanism available for the distributors. Moreover, the distributors shall be entitled to receive any %age sharing of the Management Fee by the AMC/PFM as duly disclosed; where such fee shall be paid from within the Management Fee payable to the AMC/PFM by the MUTUAL FUND/PENSION FUND)*

5.7. Ban on Re-tagging of Investors: Complete ban on re-tagging of the investors emanating from a particular distributor to the AMC/PFM itself. Re-tagging from one distributor to another shall only be allowed through a request in writing by the investors/participant; where the trailing commission for the former distribution shall stop to accrue on the date of re-tagging while the later distributor shall only be able to charge commission on trailing investments after the expiry of a cool-off period of 90 days.

Desired Impact: *The proposal is targeted at addressing the discomfort shared by several distributors in terms of practices by AMCs to directly approach and take-away their clients. The deMutual Fundion of investment, either directly or through the distributor, must rest solely with the investor himself.*

5.8. Introduction of Market Development Charges:

Market Development Charges shall be applied as follows;

<u>To be charged to Fund:</u>

Type of MUTUAL FUND	Rate	Frequency of payment	Borne by
For all MUTUAL FUND Categories except FOF and ETF	0.03% per annum of Average Net Assets of MUTUAL FUND calculated on daily basis	Monthly	Fund
FOF and ETF	Nil	NA	NA

To be paid by Trustee from its Remuneration:

Type of MUTUAL FUND	Rate	Frequency of payment	Borne by
For all MUTUAL FUND Categories	0.03% per annum of Average Net Assets of MUTUAL FUND calculated on daily basis	Monthly	Trustee

<u>Desired Outcome:</u> *<u>The amounts received will be deposited into a Market Development Fund established for MUTUAL FUND industry, aimed at investor education, awareness, and market development activities of the MUTUAL FUNDs.</u>*

<u>Disclaimer:</u> This is an easy-to-understand non-technical proposal backed by extensive market data-based research for public feedback. Any policy initiative which may emanate from this public consultation shall become applicable after due changes in the respective elements of the Regulatory framework.

Thank You.

Thank you for taking the time to review our consultation paper. We look forward to your valuable comments and feedback, which will contribute to the collective benefit of the mutual/pension fund industry.

For Feedback and Comments

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