

The Islamic asset management industry in Pakistan: Where are we heading in 2016?

Industry overview

The asset management industry in Pakistan came into inception about 50 years ago. However, it remained confined to public sector entities until the early 1990s. The first mutual fund was launched in 1962 when the National Investment (Unit) Trust was set up. In the early 1990s, many investment advisory companies were set up in the private sector offering closed-end mutual funds and in 1995, open-end funds were allowed in the private sector for the first time.

Today, there are 22 asset management companies (AMCs) operating in the country, offering 178 open-end mutual funds and three closed-end mutual funds, along with 17 voluntary pension funds. These AMCs are also offering investment advisory and asset management services to the clients, while also managing separately managed accounts, including discretionary and non-discretionary portfolio mandates.

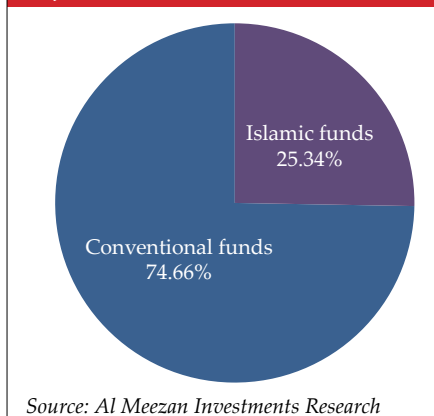
The first license for a fully-fledged Shariah compliant AMC was issued in 2003 when Al Meezan Investment Management was issued an asset management license. To date, Al Meezan has the privilege of being the only fully-fledged Shariah compliant AMC in the country.

Before we deliberate on what lies ahead for Islamic asset management in 2016, let us take a look at a brief overview of where this industry stands today, as the fiscal year 2015 (FY-15) has just concluded.

Assets under management (AUM) of the mutual funds industry stood at PKR415 billion (US\$4.05 billion) as of June 2015, up nearly 3% year-on-year. During FY-15, 11 new funds under different categories were launched.

Shariah compliant funds contributed about PKR105.3 billion (US\$1.03 billion) to the overall industry, capturing a

Chart 1: Islamic market share in the industry
(as of June 2015)



Source: Al Meezan Investments Research

market share of 25.3% as of June 2015.

Shariah compliant funds have been rapidly making a mark in the asset management industry of Pakistan. In a short span of five years, the Islamic funds' market share has increased from around 12% to over 25%. It is also worth noting that Islamic AUM have grown by a cumulative annualized growth rate (CAGR) of around 35% over the past five years compared to a meager CAGR of 12% in AUM of conventional funds.

AUM of the mutual fund industry made up 5.6% of the total banking deposits, whereas AUM of the Islamic mutual

funds constituted 8% of the Islamic banking deposits as of March 2015. This depicts significant potential for Shariah compliant investments to evolve in this largely untapped market.

It is worth noting that equity/equity index funds comprised over 39% of the total industry AUM and amounted to PKR162 billion (US\$1.58 billion), while fixed income/money market funds captured a significant chunk of around 47% of the overall size, with AUM of PKR196 billion (US\$1.91 billion), as of June 2015.

Islamic equity funds have performed impressively, posting a five-year annualized return of 31.48% on the CAGR basis. It is pertinent to mention that the KSE Meezan Index (KMI-30), the only Shariah compliant equity index in Pakistan launched jointly by the Karachi Stock Exchange (KSE) and Al Meezan Investment Management, has been used as a proxy for Islamic funds' performance. For the same period, the conventional index KSE-100 has generated an annualized return of 28.75% on the CAGR basis. In the Islamic fixed income funds category, the money market and sovereign funds (holdings of Sukuk issued by the government of Pakistan) have provided annualized returns of 10.23% and 11.29% respectively



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on a five-year basis.

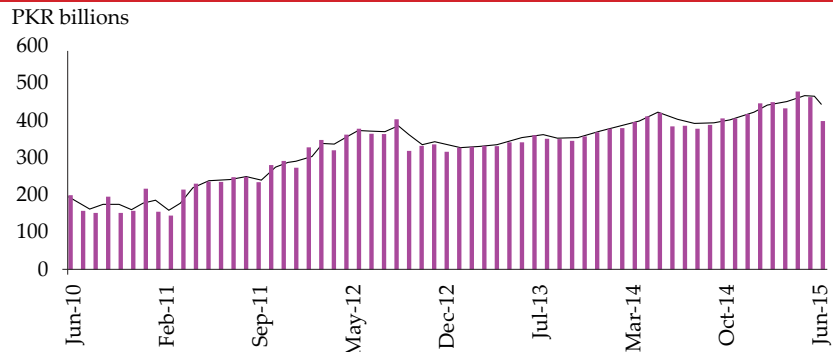
Other notable categories of mutual funds include the preservation/capital protected funds, which captured over 8% of the market, with AUM of over PKR34 billion (US\$331.47 million). The asset allocation funds category added up to over PKR16 billion (US\$155.99 million), representing around 4% of AUM, while the balanced funds category contributed about 1% to industry AUM with around PKR5 billion (US\$48.75 million), as of June 2015.

The Islamic mutual funds industry of Pakistan has seen immense growth in the past few years. With increased awareness on various financial savings options, investors have become active in investing through mutual funds as opposed to the traditional means of savings. The strong growth in Islamic funds' AUM is predominantly due to a desire to invest in Shariah compliant modes. Furthermore, Islamic equity funds and Islamic equity index funds have depicted less volatility and better returns relative to conventional funds as the Shariah screening criteria provide a benefit in the form of investment in companies with healthier balance sheets. It is also pertinent to note that Pakistan, being an Islamic country, is witnessing an ever-increasing demand for Shariah compliant (Islamic) products and a similar trend is also observed for Islamic banking deposits in Pakistan.

Besides being the only fully-fledged Shariah compliant AMC in the country, Al Meezan is also the largest AMC in the private sector, with a market share of 57% in the Islamic funds category and over 14% in the overall asset management industry. Al Meezan is the first AMC in the industry to be awarded the highest credit rating of 'AM2+' by the credit rating agency, JCR-VIS. Moreover, Al Meezan manages the largest equity fund and voluntary pension fund in the industry with AUM of PKR27.4 billion (US\$267.12 million) and PKR4.5 billion (US\$43.87 million) respectively as of June 2015. Given the robust growth of Islamic funds, more and more AMCs are now focusing on the Shariah compliant segment of the market.

As of now, the major share of total assets under management is held by local investors. Among these, institutions form

Chart 2: Industry AUM



Source: Al Meezan Investments Research

the primary investor base, (nearly 80% of the total assets under management of the industry). In the past 10 years, the proportion of retail investment has increased from 10% to 20% which is still quite low. However, with proper focus as well as newer initiatives aimed at enhancing retail awareness/penetration, the industry is expected to achieve a better balance.

Public sector investment in the mutual funds industry is not substantial. National savings schemes and bank deposits have traditionally been the preferred investment avenues for these types of investors. However recently, growing awareness has seen an increase in participation by such public sector entities in the overall AUM of the industry.

Commodity funds and REITs

So far, there are no Shariah compliant commodity funds in the country. Even the size of conventional commodity funds is miniscule (only around PKR340 million (US\$3.31 million), as of June 2015) given the low volumes of trading at the Pakistan Mercantile Exchange, the only commodity exchange to exist and operate in Pakistan. In the near future however, we are likely to see the launch of the first Shariah compliant commodity fund in the country, in the form of 'Meezan Gold Fund'.

REITs and private equity funds are other avenues with huge potential for growth. Recently, the Securities and Exchange Commission of Pakistan (SECP) relaxed its stringent regulatory requirements pertaining to REITs which has led to the launch of the first-ever Shariah compliant REIT in June 2015 called the 'Dolmen City REIT'. Moreover, the SECP has also

proposed to allow AMCs to manage REITs, since at present, AMCs were required to set up separate companies should they need to launch such funds under existing regulations. It is expected that with these anticipated changes in regulations, there will be a surge in activity related to Shariah compliant REITs in the country.

Challenges faced by Islamic funds

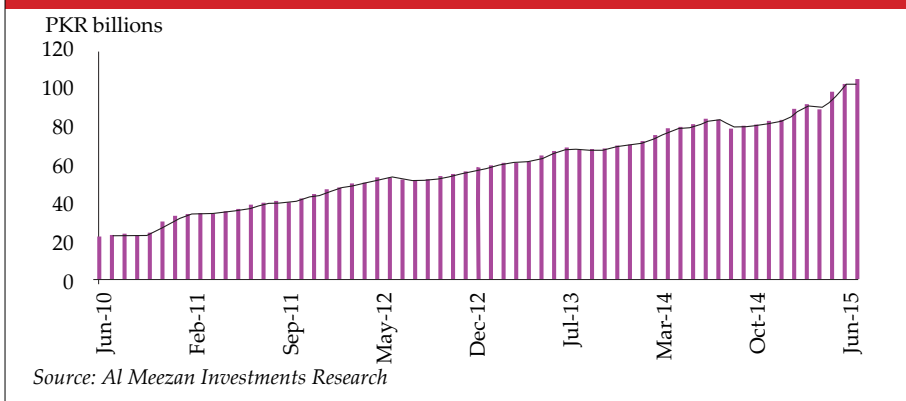
Shariah compliant mutual funds have played a vital role in the growth of the mutual fund industry in Pakistan. Islamic fixed income and money market funds which contribute a significant 41% to the overall Islamic mutual fund segment, continue to face significant challenges. The most critical challenge being the lack of availability of Islamic investment avenues as the total Shariah compliant paper/bonds/Sukuk issued by the government as well as the private sector is just a fraction of the overall debt market in the country.

In this regard, it is pertinent to mention that the central bank of Pakistan issued a total of 15 Sukuk Ijarah worth PKR550 billion (US\$5.36 billion) in the last eight years. However, new issuance of Sukuk Ijarah has stopped for the past one year and hence Islamic institutions are finding it difficult to re-deploy the funds generated due to the maturity of some of these Sukuk which were issued over three years ago.

Some of the other challenges that are being faced by the Islamic funds industry include a low awareness of the mutual funds sector in general, along with a low understanding of Islamic finance facilities, a smaller distribution network of AMCs when compared to banks and

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Chart 3: AUM of Islamic mutual funds



a dearth of talented human resources to fully capitalize on the potential of this industry.

Funds' outlook

While challenges exist, multiple positive developments are also emerging that are expected to positively impact the growth of the mutual funds industry.

Despite these challenges, the Islamic mutual fund industry showed substantial growth of over 35% in the last five years. One of the major impetus

behind the growth of Islamic funds is the stellar stock market performance of Pakistan. In this regard, the KMI-30 has registered a CAGR of 31.48% over the last five years depicting the growth potential of Islamic equity funds in Pakistan. In addition, the declining interest environment for the last couple of years has forced retirement funds to look for avenues providing better yield and overall return. The dividend yield of the market now stands at 5.5% and considering the earning growth of 16% of major KSE-100 listed companies, we

foresee more inflows in equity funds and outflows from money market and government securities funds.

Over the past few years, investors' participation in mutual funds has been more toward Islamic equity and preservation funds. Furthermore, due to the growing demand for Shariah compliant avenues, institutions have come up with Islamic windows to facilitate this surge in demand for Islamic products. The resulting behavior of market participants, coupled with a bullish stock market and a declining interest rate scenario, have triggered growth prospects for this industry. Therefore, a positive outlook is expected for such funds going forward.

In summary, there is a huge potential for growth in Islamic asset management in Pakistan and the phenomenal growth it has recorded in the recent past is likely to continue in 2016 and beyond. ☺

Mohammad Shoaib is CEO of Al Meezan Investment Management. He can be contacted at mohammad.shoaib@almeezangroup.com.

Al Meezan Investment Management: A subsidiary of Meezan Bank



Al Meezan Investment Management (Al Meezan) is the subsidiary of Meezan Bank. The core area of Al Meezan's business is investment management with its proven expertise in:

- Developing, floating and managing Islamic (Shariah compliant) mutual funds
- Structuring and managing discretionary and non-discretionary portfolios, and
- Providing investment advisory services.

Al Meezan with an 'AM2+' management quality rating (awarded by JCR-VIS) is the largest fund manager in the private sector in Pakistan and the only Shariah compliant asset management company in Pakistan. Al Meezan has successfully

completed 20 years of its existence in 2015. This is one of the longest track records in the private sector in the area of investment management in Pakistan and it has emerged as one of Pakistan's leading investment solutions providers in a Shariah compliant manner. Al Meezan has recorded phenomenal growth over the last five years with its assets under management (AUM) growing from PKR17.8 billion (US\$173.53 million) in January 2010 to about PKR66.4 billion (US\$647.34 billion) on the 30th June 2015, reflecting an impressive 273% growth in AUM in the last five years.

Al Meezan also boasts the largest penetration among retail investors in the country with a total investor base of over 33,000 investors. Not only that, it is perhaps one of the few institutions in the country which has helped investors achieve their investment objectives in a truly Shariah compliant manner. The investment solutions offer a range of options, including diversified equity schemes, fixed income funds, money

market products, a capital preservation fund series and a voluntary pension scheme. Al Meezan is presently managing 11 funds and administrative plans under these categories. Al Meezan is also set to launch its first-ever Shariah compliant commodity scheme, the Gold Fund, in Pakistan this year. The Shariah advisors of Meezan Bank are also the Shariah advisors of Al Meezan and supervise the operations to ensure Shariah compliance of the funds. In addition to the service quality, Shariah compliance and impressive performance in terms of returns to investors, Al Meezan also complies with global best practices in asset management and has voluntarily adopted the Asset Manager Code of Professional Conduct from CFA Institute in the US. Hence, it has the distinction of being the first asset management company in Pakistan to comply with global best practices in asset management. Al Meezan is also compliant with the Global Investment Performance Standards (GIPS).

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A story of success, written in rewards

Al Meezan Investments continues on its path of success through the provision of high quality services and investment management capabilities. Testament to these efforts is the **Best Regional Fund Performance** Award by the prestigious **Islamic Finance News Awards**.

AM2+
Rating as per JCR-VIS



Al Meezan
Investment Management Ltd.



A subsidiary of
Meezan Bank
The Premier Islamic Bank

0800 - HALAL (42525)
(021) or (042) 111-633-926 (111-MEEZAN)

SMS "invest" to 6655
info@almeezangroup.com
www.almeezangroup.com