



Modarabas & NBFCs Sector Study

TABLE OF CONTENTS

Contents	Page No.	Contents	Page No.
Introduction	1	NBMFCs Borrowers & Loan Sizes	16
Global Industry Overview	2	REITs/Trusts and Investment Banks An Overview	17
Macro Economic Indicators Annual	3	Investment Banks Asset Break-up and Financial Position	18
Macro Economic Indicators Monthly	4	Modarabas An Overview	19
Local Industry Overview	5	Modarabas Assets	20
Local Industry Total Assets	6	Modarabas Profitability	21
Total Assets Shariah Compliant & Conventional	7	Pension Funds An Overview	22
Total Assets Break-up	8	Leasing Companies & Private Equity An Overview	23
Financing Asset & Sector Wise	9	Regulatory Framework	24
Local Asset Management Companies	10	Taxation	25
AMCs Net Sales	11	Latest Developments	26
Mutual Funds An Overview	12	Ratings Chart	28
Mutual Funds Break-up of Investor Accounts	13	SWOT Analysis	29
Discretionary/Non – Discretionary Portfolios	14	Outlook	30
NBMFCs An Overview	15	Bibliography	33

Modarabas & NBFCs

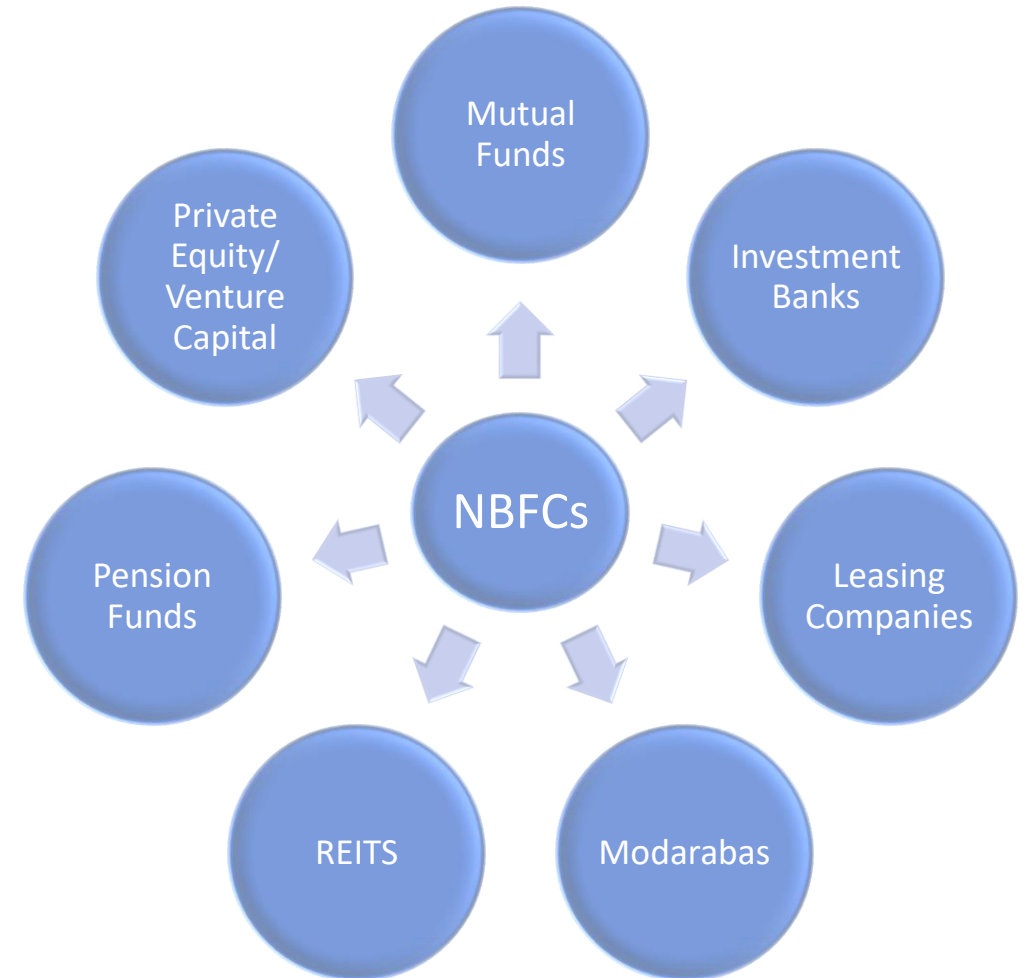
Introduction

Non-bank Financial Companies (NBFCs), also known as Non-Bank Financial Institutions (NBFIs), are financial institutions that offer various banking services but do not have a banking license.

Generally, these institutions are not allowed to take traditional demand deposits—readily available funds, such as those in checking or savings accounts—from the public. This limitation keeps them outside the scope of conventional oversight from federal and state financial regulators.

The NBFCs sector mainly comprises the following:

- Mutual Funds
- Investment Banks
- Pension Funds
- Insurance Companies
- Other Financial Intermediaries (OFIs) - OFIs include all financial intermediaries that are not central banks, banks, public financial institutions, insurance corporations, pension funds, or financial auxiliaries. They mainly include investment funds, captive financial institutions and money lenders, central counterparties, broker-dealers, trust companies and structured finance vehicles.



Global | Overview

- Total global financial assets grew by ~7.7% to USD~486.6trn in CY21. While the NBFCs sector’s growth was slower than that of central banks sector in CY21 (12%), it was higher than the five-year average from CY16-20 (~6.6%) and that of banks (~5.5%).
- At a global level, the NBFCs sector grew by ~8.9% in CY21 to USD~239.3trn while banks grew by 5.5% to USD~182.9trn .
- The NBFCs sector accounted for ~49.2% of global financial assets in CY21 as compared to ~48.6% in the previous year.
- The sector growth rate achieved in CY21 exceeds a five-year historical average growth of ~6.6%, being driven by accommodative monetary policies and low interest rates which contributed to higher asset valuations for equity investment funds. This led to greater inflows as investors shopped around for higher investment yields.
- In CY21, the NBFCs sector share of global financial assets exceeded that of banks (~37.6%); the latter’s share fell below that of the former as the strong growth exhibited by banking assets in CY20 started to slow down following the lifting of pandemic-related measures to support the economy (primarily quantitative easing measures).
- Non-bank financial entities play an increasing important role in providing financing to the real economy, as well as in managing the savings of households and corporate entities.

Global NBFCs Assets CY21	Share (%)	Size (USD trn)
Investment Funds (other than MMFs and Hedge Funds)	29.5%	66
Insurance Corporations (ICs)	17.9%	40
Pension Funds (PFs)	20.0%	45
Captive Financial Institutions and Money Lenders (CFIMLs)	10.7%	24
Broker-dealers (BDs)	5.8%	13
Money Market Funds (MMFs)	4.0%	9
Hedge Funds	3.1%	7
Structured Finance Vehicles (SFVs)	2.7%	6
Finance Companies	2.7%	6
Trust Companies	1.8%	4
REITs	1.3%	3
Central Counterparties (CCPs)	0.4%	1
Total	100.0%	224

Modarabas & NBFCs

Macro Economic Indicators | Annual

	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	9MFY22	9MFY23
Average Inflation Rate (CPI)	7.4%	8.6%	4.5%	2.9%	4.2%	3.9%	7.3%	10.7%	8.9%	12.10%	10.7%	27.20%
Average KIBOR	9.8%	9.9%	8.9%	6.5%	6.1%	6.4%	10.4%	12.0%	7.4%	10.83%	9.6%	17.09%
Monetary Policy Rate (MPR)	9.9%	9.8%	8.8%	6.0%	5.8%	6.0%	9.7%	11.8%	7.0%	9.50%	8.3%	16.17%
PKRV	9.6%	9.8%	8.7%	6.3%	6.0%	6.3%	10.2%	11.8%	7.3%	10.68%	9.4%	16.92%
Average Exchange Rate (PKR/USD)	96.8	102.8	101.5	104.4	104.8	110.1	136.4	158.4	160.5	180.8	172.3	236.80
(USD mln)	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	9MFY22	9MFY23*
Current Account Balance	(2,496)	(3,130)	(2,815)	(4,961)	(12,270)	(19,195)	(13,434)	(2,970)	(1,852)	(13,779)	(12,077)	(3,861)
Exports	24,802	25,078	24,090	21,972	22,003	24,768	24,257	22,536	25,630	31,792	25,119	23,417
Imports	40,157	41,668	41,357	41,118	48,001	55,671	51,869	43,645	53,785	80,177	54,972	42,506
Trade Balance	(15,355)	(16,590)	(17,267)	(19,146)	(25,998)	(30,903)	(27,612)	(21,109)	(28,155)	(48,385)	(29,853)	(19,089)
Foreign Exchange Reserves	11,020	14,141	18,699	23,099	21,403	16,384	14,482	18,886	24,398	15,450	17,426	9,760

*Data available until Feb'23, except for Foreign Exchange Reserves.

Modarabas & NBFCs

Macro Economic Indicators | Monthly

	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23
Average Inflation Rate (CPI)	13.00%	12.20%	12.70%	13.40%	13.80%	21.30%	24.90%	27.30%	23.20%	26.60%	23.80%	24.50%	27.60%	31.50%	35.40%
Average KIBOR	11.32%	10.82%	11.85%	13.52%	14.90%	15.41%	15.66%	15.96%	16.05%	15.81%	16.01%	17.00%	17.38%	18.71%	21.27%
Monetary Policy Rate (MPR)	9.75%	9.75%	9.75%	12.25%	13.00%	13.75%	15.00%	15.00%	15.00%	15.00%	15.50%	16.00%	17.00%	17.00%	20.00%
PKRV	11.13%	10.67%	11.78%	13.13%	14.78%	15.25%	15.39%	15.78%	15.83%	15.64%	15.87%	16.90%	17.33%	18.54%	20.97%
Average Exchange Rate (PKR/USD)	177	176	180	202	214	204	29	221	231	221	222	225	235	276	282
(USD mln)	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23*
Current Account Balance	(2,531)	(545)	(1,006)	(640)	(1,513)	(2,169)	(1,215)	(676)	(363)	(569)	(276)	(400)	(230)	(74)	-
Exports	2,497	2,885	3,763	3,779	2,990	3,770	2,835	3,387	3,021	2,834	2,888	2,304	2,211	2,772	-
Imports	6,314	5,166	7,218	7,028	6,550	8,353	6,151	6,649	5,571	5,288	4,978	5,161	4,856	4,544	-
Trade Balance	-3,817	-2,281	-3,455	-3,249	-3,560	-4,582	-3,316	-3,262	-2,550	-2,454	-2,090	-2,857	-1,692	-1,772	-
Foreign Exchange Reserve	22,836	22,638	18,545	16,406	15,219	15,537	14,024	14,347	13,310	14,278	13,027	11,423	8,170	8,737	9,760

*Subject to latest data availability.

Modarabas & NBFCs

Local | An Overview

Pakistan’s economy demonstrated robust growth in FY22, posting a real GDP growth rate of ~5.97%. However, this growth was not sustainable in FY23 which commenced with the monsoon flash floods of Aug’22 which caused catastrophic economic losses to Pakistan’s economy. These are estimated at USD~10bln while annual real GDP growth projection has been drastically cut down to 0.5% by the IMF.

Pakistan’s Modarabas & NBFCs sector consists of conventional and Shariah-compliant Non-Bank Financial Institutions namely:

- Modarabas
- Mutual Funds
- Pension Funds
- REITs
- Leasing companies
- Investment Finance Services

Modarabas & NBFCs provide financial products to individuals and businesses for their financing needs. This Sector Study shall focus on the Asset base of different categories of NBFCs in order of their percentage share in the total NFBCs’ Assets.

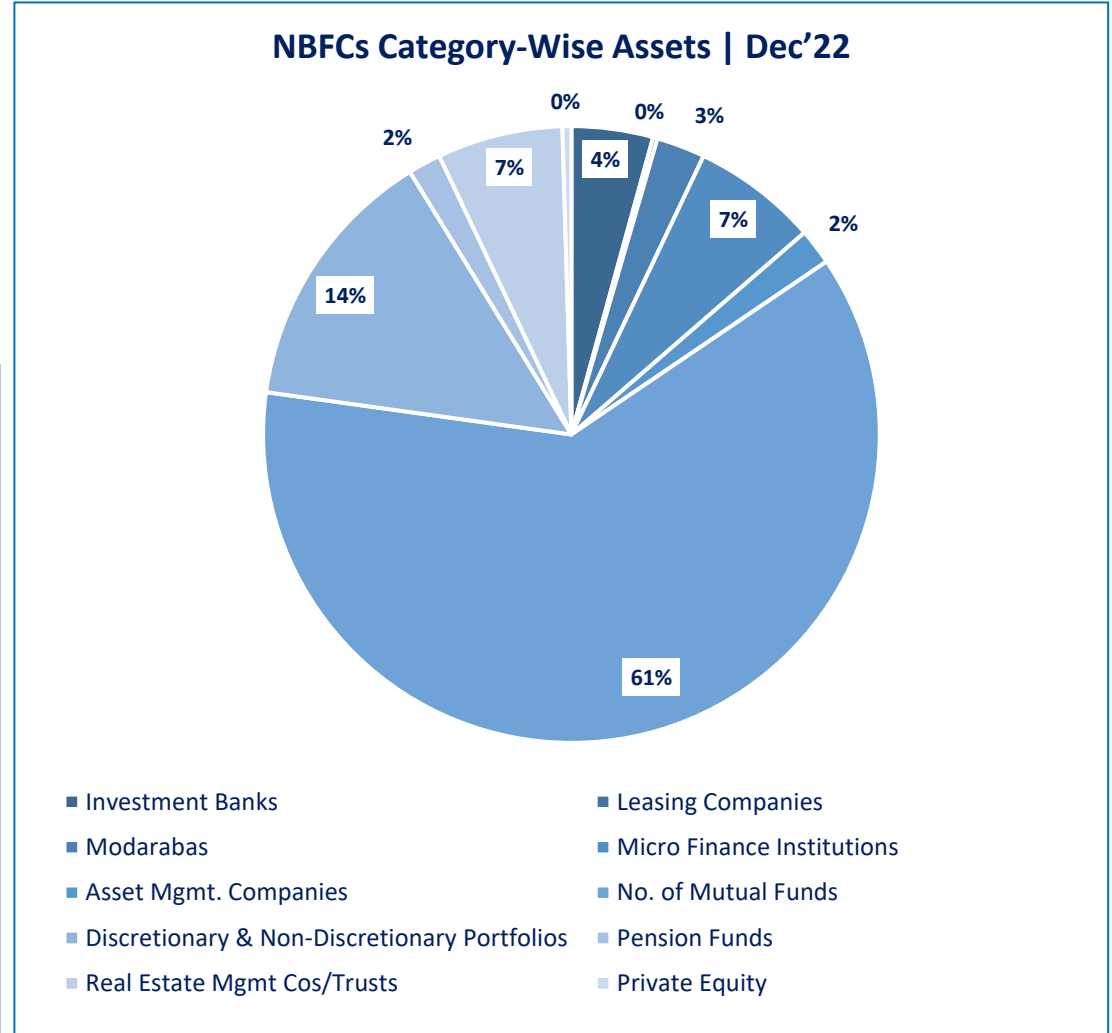
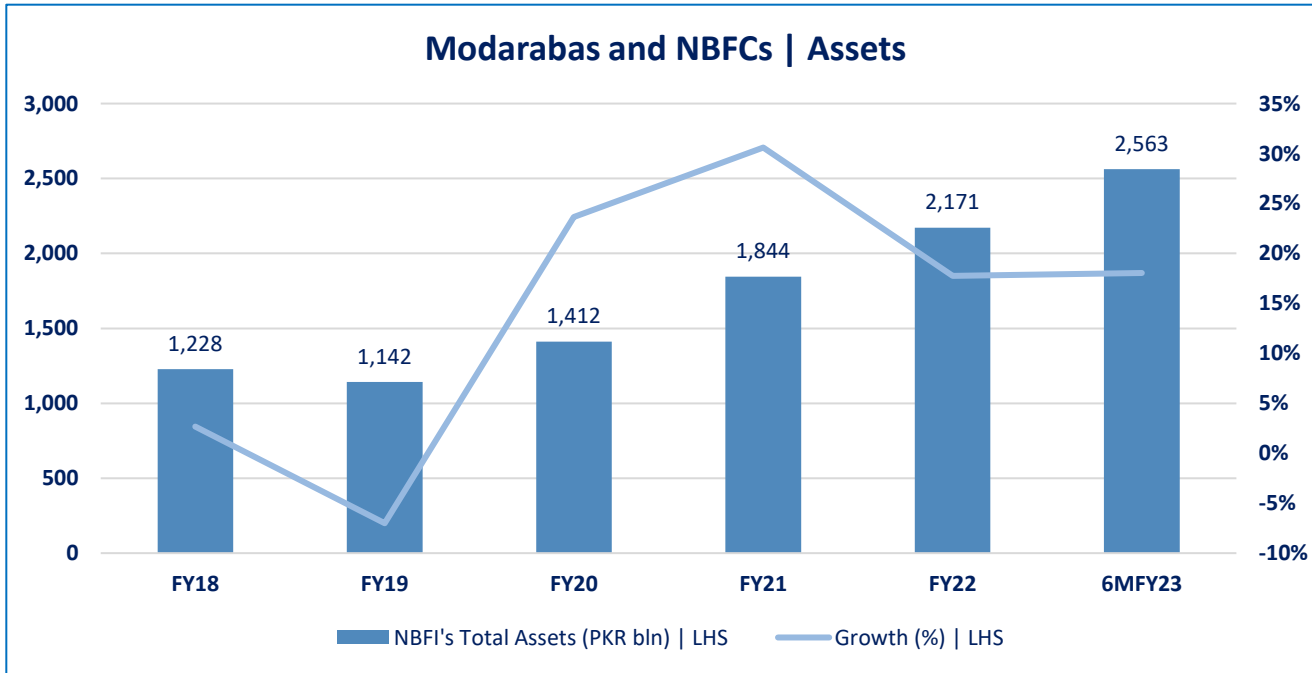
Total Assets (PKR bln)	FY21	FY22	6MFY23
Mutual Funds	1,087	1,281	1,574
Discretionary & Non-Discretionary Portfolios	338	356	358
Real Estate Mgmt. Cos/Trusts	61	106	168
Micro Finance Companies	138	163	168
Investment Banks	63	91	109
Modarabas	55	61	65
Asset Management Companies	45	53	48
Pension Funds	40	42	44
Private Equity	7	11	12
Leasing Companies	5	6	6
NBFCs’ Total	1,839	2,171	2,563

Segments	No. of Entities Dec’22
Mutual Funds	313
Micro Finance Companies	35
Asset Management Companies	29
REITs	27
Modarabas	27
Pension Funds	24
Investment Banks	20
Private Equity Companies & Funds	14
Leasing Companies	4
Total	498

Modarabas & NBFCs

Local | Total Assets

- Total assets of Modarabas & NBFCs have grown from PKR~1,228bln in FY18 to PKR~2,563bln at End-1HFY23, representing a CAGR of ~16%.
- Mutual Funds & Plans have the highest share of ~61%, while Modarabas hold a share of ~3% in the total assets of Modarabas and NBFCs.

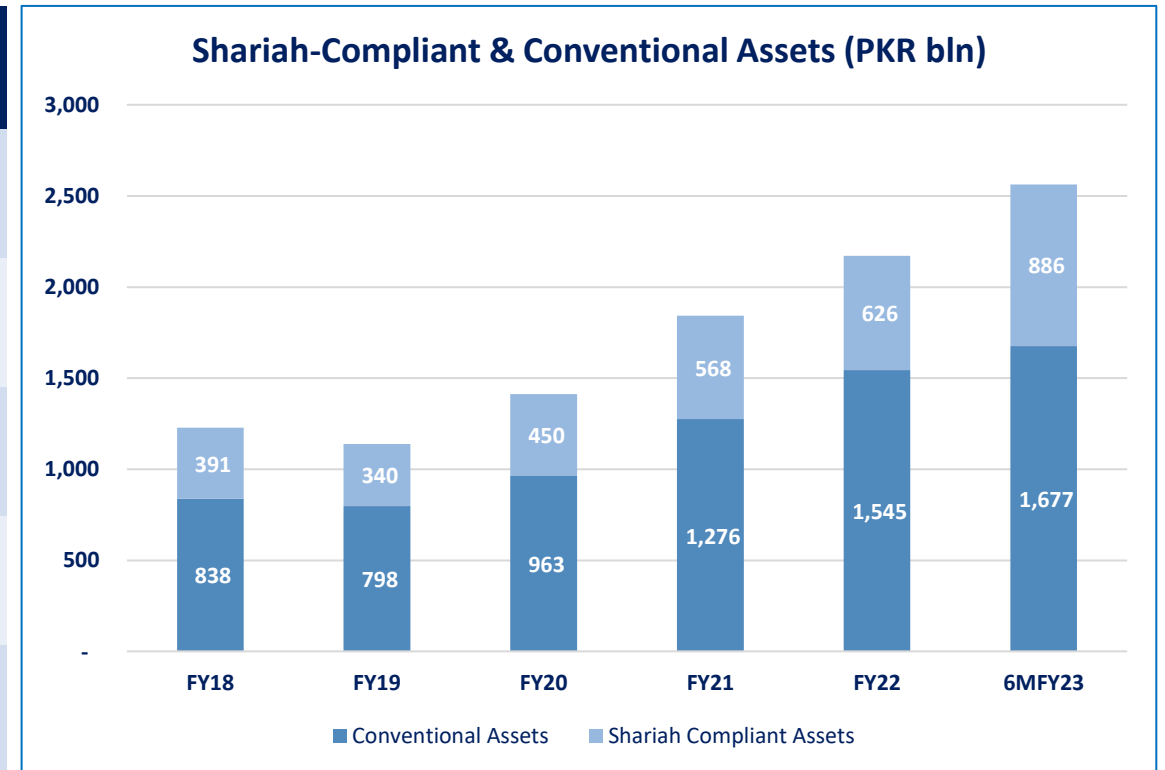


Modarabas & NBFCs

Total Assets | Shariah Compliant & Conventional

- The share of Shariah-compliant assets has remained at an average of ~31% over the last 5 periods (FY18-22).
- Conventional and Shariah-Compliant assets registered a CAGR of 15% and 18%, respectively, in the period FY18-1HFY23.

Description (PKR bln)	FY18	FY19	FY20	FY21	FY22	6MFY23
Conventional Assets	838	798	963	1,276	1,545	1,677
Shariah-Compliant Assets	391	340	450	568	626	886
Total Assets	1,229	1,138	1,412	1,844	2,171	2,563
Share of Conventional Assets	68%	70%	68%	69%	71%	65%
Share of Shariah-Compliant Assets	32%	30%	32%	31%	29%	35%



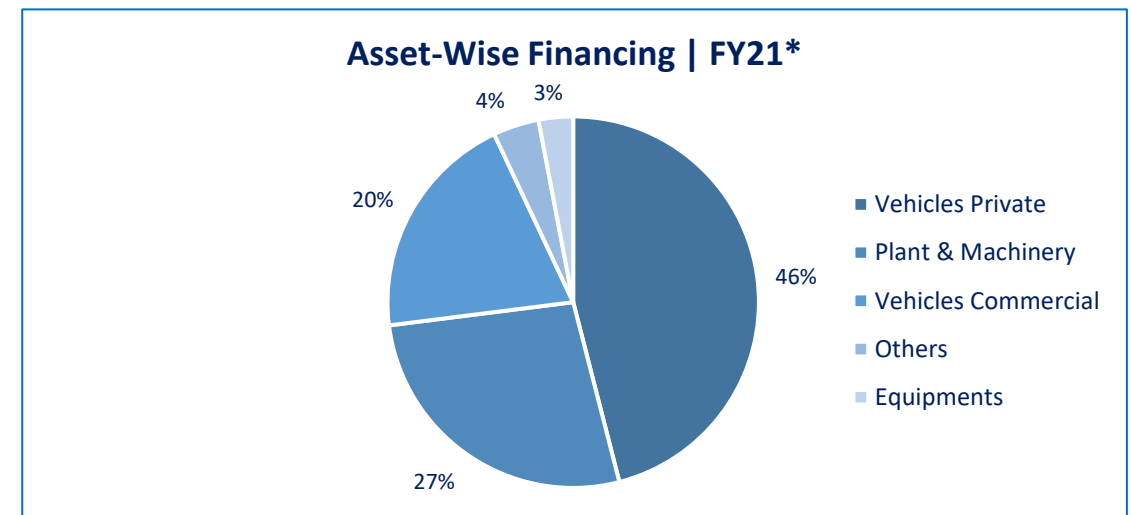
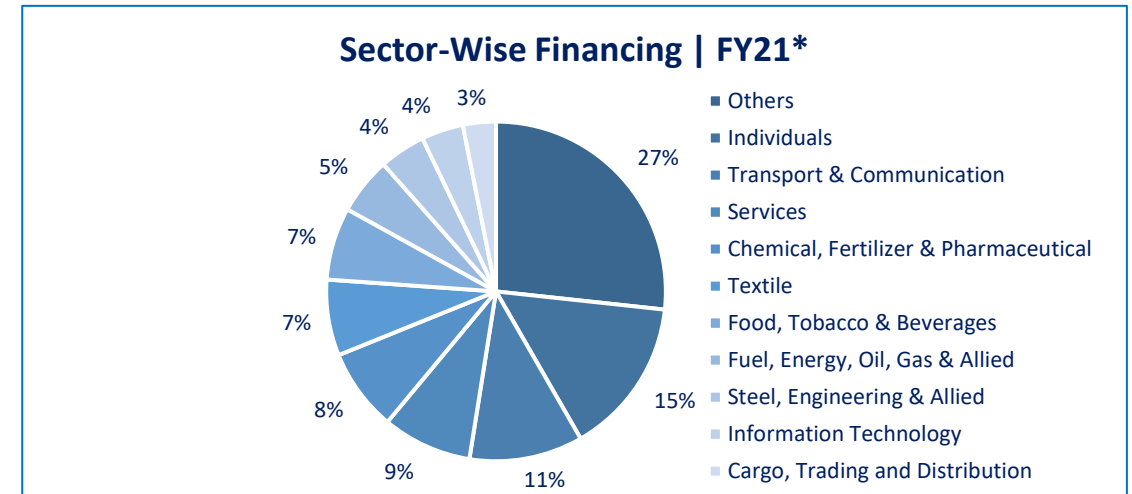
Total Assets | Break-up

Type	FY20			FY21			FY22			Dec'22		
	No. of Entities	Total Assets (PKR bln)	Assets Share in Modarabas & NBFCs	No. of Entities	Total Assets (PKR bln)	Assets Share in Modarabas & NBFCs	No. of Entities	Total Assets (PKR bln)	Assets Share in Modarabas & NBFCs	No. of Entities	Total Assets (PKR bln)	Assets Share in Modarabas & NBFCs
Investment Banks	12	65	5 %	13	63	3 %	17	91	4%	304	109	4%
Leasing Companies	7	11	1 %	5	5	1 %	4	6	0%	27	6	0%
Modarabas	28	51	4 %	28	55	3 %	27	61	3%	35	65	3%
Micro Finance Institutions	25	122	9 %	29	138	7 %	32	163	8%	86	168	7%
Lending Institutions Total	72	249	17%	75	261	14 %	80	321	15%	29	348	14%
Asset Management Companies	23	40	3 %	24	45	2 %	28	53	2%	313	48	2%
Mutual Funds	220	802	57 %	282	1,087	60 %	290	1,281	59%	-	1,574	62%
Discretionary & Non-Discretionary Portfolios	-	229	16 %	-	338	18 %	0	356	16%	24	358	14%
Pension Funds	19	31	2 %	19	40	2 %	22	42	2%	27	44	2%
Real Estate Mgmt Cos/Trusts	8	55	4 %	11	61	3 %	18	106	5%	14	168	7%
Private Equity	9	7	1 %	12	7	1 %	14	11	1%	14	12	0%
Investing Institutions Total	279	1,163	82 %	348	1,578	86 %	372	1,849	85%	407	2,204	86%
NBFCs' Total	351	1,412	100 %	423	1,839	100 %	452	2,170	100%	493	2,552	100%

Modarabas & NBFCs

Financing | Asset & Sector-Wise

- The Modarabas & NBFCs sector is essential for economic development of the country. In Pakistan, there are an estimated ~5.0mln small and medium enterprises (SMEs). Their contribution to the GDP is estimated to be ~40% while that to exports is estimated around ~25%.
- In FY21 the sector contributed PKR~16bln to SMEs which comprised ~54% of the financing disbursement (FY20: PKR~10.7bln and ~52%, respectively) indicating a growing interest towards SME financing.
- Commercial Banks' lending to SMEs constituted only ~7% of their total lending to private sector businesses by Feb'23, as per the SBP.
- The major asset holder in the NBMFC sector is Mutual funds (~61%). On the contrary, the popularity of modarabas is slowly with the total assets of associated companies comprising ~3% of the total (sector) asset portfolio. The popularity of mutual funds is driven by the diverse product structure offered by mutual fund providers, attractive returns, and diversified investment exposure which is an attractive alternative investment vehicle to equity market investments. In addition, the range of benefits differ from fund to fund but an investor has the liberty to select the vehicle which best suits his or her investment needs.



*Above Information pertains to latest available data for FY21.

Local | Asset Management Companies

Mutual Funds Industry - Assets Under Management PKR bln (Open End & VPS, excluding Fund of Funds)									
Sr.	Asset Management Company	Dec-20	Jun-21	Dec-21	Jun-22	Dec-22		Feb-23	
		AUMs	AUMs	AUMs	AUMs	Market Share	AUMs	Market Share	AUMs
1.	Al-Meezan Investment Management Limited	163	189	173	192	17%	267	19%	287
2.	NBP Fund Management Limited	163	168	169	177	14%	213	15%	219
3.	UBL Fund Managers Limited	91	102	116	138	10%	165	10%	157
4.	MCB-Arif Habib Savings and Investments Limited	83	98	110	121	10%	160	10%	155
5.	HBL Asset Management Limited	78	72	94	138	10%	156	10%	149
6.	ABL Asset Management Limited	67	79	89	98	8%	127	6%	93
7.	National Investment Trust Limited	85	90	88	88	6%	88	5%	80
8.	Faysal Asset Management Limited	47	62	76	75	7%	104	7%	109
9.	Alfalah GHP Investment Management Limited	50	55	60	61	5%	75	5%	69
10.	Atlas Asset Management Limited	40	50	52	46	3%	49	3%	47
11.	Al Habib Asset Management Limited	26	33	40	50	5%	75	4%	54
12.	JS Investment Limited	24	17	23	28	3%	43	2%	29
13.	Lakson Investments Limited	22	23	20	25	2%	26	1%	22
14.	Pak Oman Asset Management	7	6	8	6	1%	9	1%	9
15.	AKD Investment Management Limited	7	9	7	7	0%	6	0%	6
16.	AWT Investment Management Limited	2	2	2	2	0%	4	0%	4
17.	786 Investments Limited	1	1	1	1	0%	1	0%	1
18.	First Capital Investments Limited	0	0	0	0	0%	0.1	0%	0
19.	Pak Qatar Asset Management Company Limited*	0	-	0	-	0%	5	0%	6
Total		955	1,054	1,127	1,252	100%	1,574	100%	1,496

*Results of Pak Qatar Asset Management Company Limited only started being published Dec-22 onwards.

Modarabas & NBFCs

Asset Management Companies | Net Sales

- Total AMC sales during CY22 stood at PKR~4,312bln while redemptions during the year clocked in at PKR~3,896bln. In 2MCY23, the sales and redemptions stood at PKR~952bln and PKR~1,003bln, respectively.
- Resultantly, net sales of AMCs amounted to PKR~477bln during CY22 and to PKR~-49bln in 2MCY23, reflecting a lack of investor participation due to deteriorated economic conditions.
- In CY22, the Shariah-Compliant money market segment experienced the highest level of net sales standing at PKR~176bln, accounting for ~37% of total net sales. Meanwhile, the equity and Shariah-Compliant equity segments witnessed a higher level of redemptions as compared to sales.

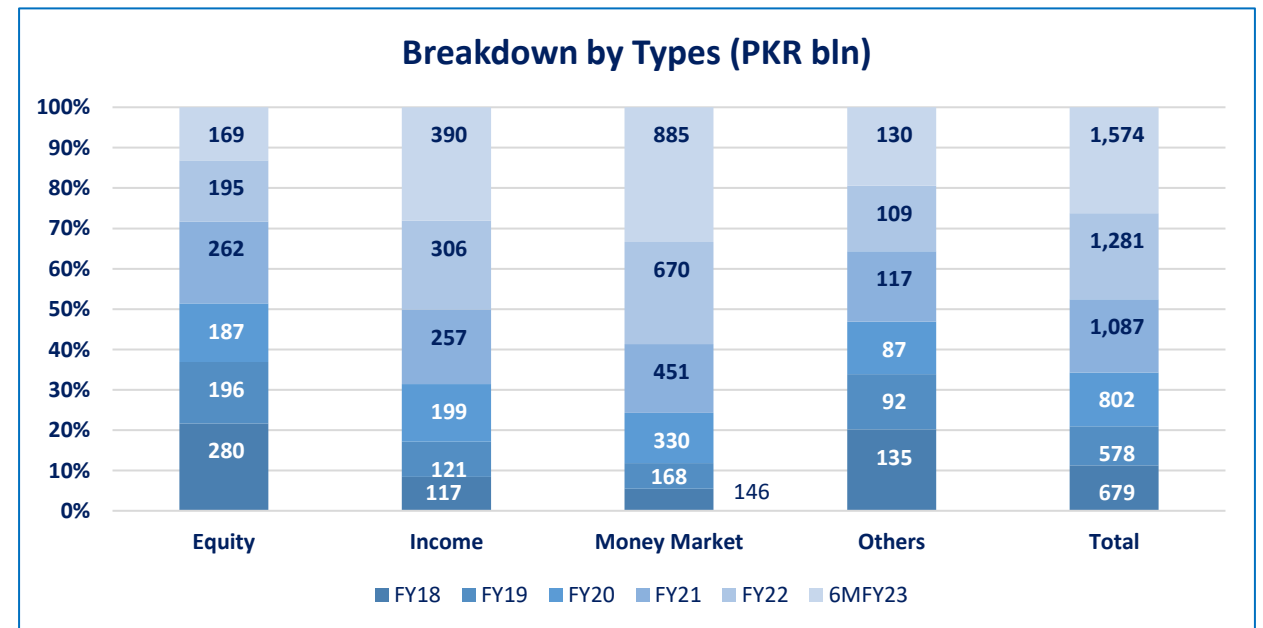
Net Sales (PKR mln)	CY22			2MCY23			
	Open End	Sales	Redemptions	Net Sales	Sales	Redemptions	Net Sales
Money Market		2,123,266	2,002,682	170,630	353,763	460,528	(106,765)
Income		519,579	464,764	46,514	132,780	143,515	(10,736)
Equity		20,896	40,705	(19,378)	3,013	11,195	(8,182)
Shariah-Compliant Money Market		1,040,973	866,865	176,178	323,486	248,977	74,509
Shariah-Compliant Income		310,061	255,075	37,245	80,780	68,644	12,136
Shariah-Compliant Equity		47,512	60,074	(13,497)	7,295	12,411	(5,115)
Other		224,924	183,565	76,660	48,464	55,502	(7,038)
VPS		24,984	22,511	2,249	2,305	2,294	2,706
ETF		298	193	169	(16)	18	(17)
Total		4,312,493	3,896,434	476,771	951,870	1,003,083	(48,502)

Modarabas & NBFCs

Mutual Funds | An Overview

- A Mutual Fund is a type of financial vehicle that pools money of investors with common financial goals. The funds are invested in securities such as stocks, bonds and money market instruments etc. in order to meet pre-defined investment objectives.
- As of End-Dec'22, Mutual Funds held the highest share of ~61% in the Modarabas & NBFCs assets space with total assets amounting to PKR~1,574bln. CAGR of Mutual Funds Assets from FY18-1HFY23 was recorded at ~18% while the total number of Mutual Funds & Plans have increased from ~262 to ~313.
- The share of fixed income securities in the total invested assets of mutual funds have increased significantly from ~39% in FY18 to ~81% at the end of 1HFY23.
- As at End-Dec'22, ~56% of the total assets were invested in the short-term money market instruments while ~25% were invested in other fixed income securities. ~11% of the assets were invested in equity market.

Description	FY18	FY19	FY20	FY21	FY22	6MFY23
Total Assets (PKR bln)	679	578	802	1,087	1,281	1,574
Growth (Period-on-Period)	-4%	-15%	39%	36%	17.9%	22.9%
Total Number of Mutual Funds & Plans	262	297	309	282	290	313



Modarabas & NBFCs

Mutual Funds | Break-up of Investor Accounts

Description	No. of Investor Accounts as at Dec 31, 2022	Value of Investment as at Dec 31, 2022 (PKR bln)	% of Total Investment Value
Resident			
Individuals	406,174	526	34%
Associated Banks/DFIs/AMCs	66	38	2%
Other Banks/DFIs	176	23	2%
Insurance Companies	374	49	3%
Other Financial Institutions	210	16	1%
Other Corporates	3,619	699	45%
Fund of Funds	70	16	1%
Retirement Funds	2,965	131	9%
Trusts/NGOs etc.	1,274	43	3%
Foreign			
Individuals	2,508	7	1%
Non-Individuals	28	0.7	0
Total	417,464	1,549	100%

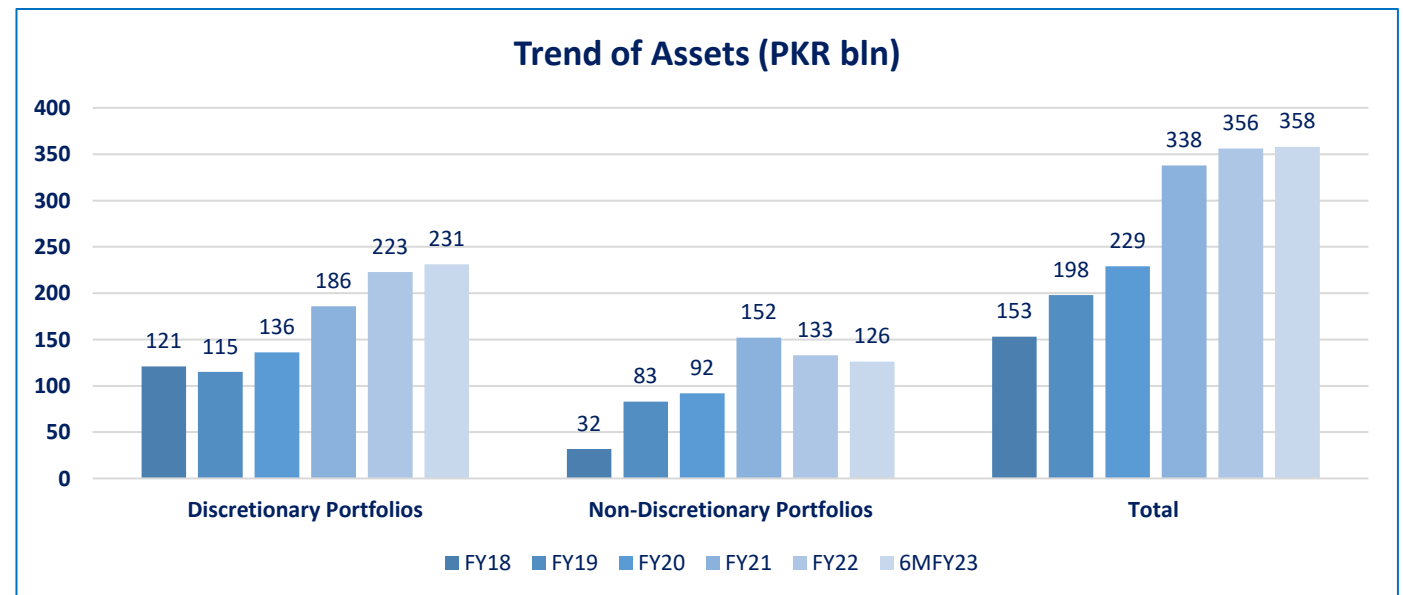
- Number of active investor accounts having more than zero balance as at 31st Dec'22 are 417,764. Number of investor accounts having 0 balance at 31st Dec'22 are 405,684. Total number of investor accounts as at 31st Dec'22 are 823,148.
- The above table shows the number of investor accounts in open end mutual funds only.
- The number of investors' accounts is different from number of investors in mutual fund industry i.e. If Investor A opens 3 accounts with 3 different AMCs, the same shall be reported as 3 investor accounts instead of 1 investor.

Modarabas & NBFCs

Discretionary/Non-Discretionary Portfolios

- In discretionary portfolios, the portfolio manager individually and independently manages the funds and securities of each client in accordance with the needs of the client.
- Under non-discretionary portfolios, the portfolio manager manages the funds in accordance with the directions of the client.
- In Pakistan these portfolios hold the second highest weight, i.e., ~14% in the Modarabas & NBFCs sector with total assets under management amounting to PKR~358bIn (End-Dec'22).

Assets (PKR bln)	FY18	FY19	FY20	FY21	FY22	6MFY23
Discretionary Portfolios	121	115	136	186	223	231
Non-Discretionary Portfolios	32	83	92	152	133	126
Total	153	198	229	338	356	358

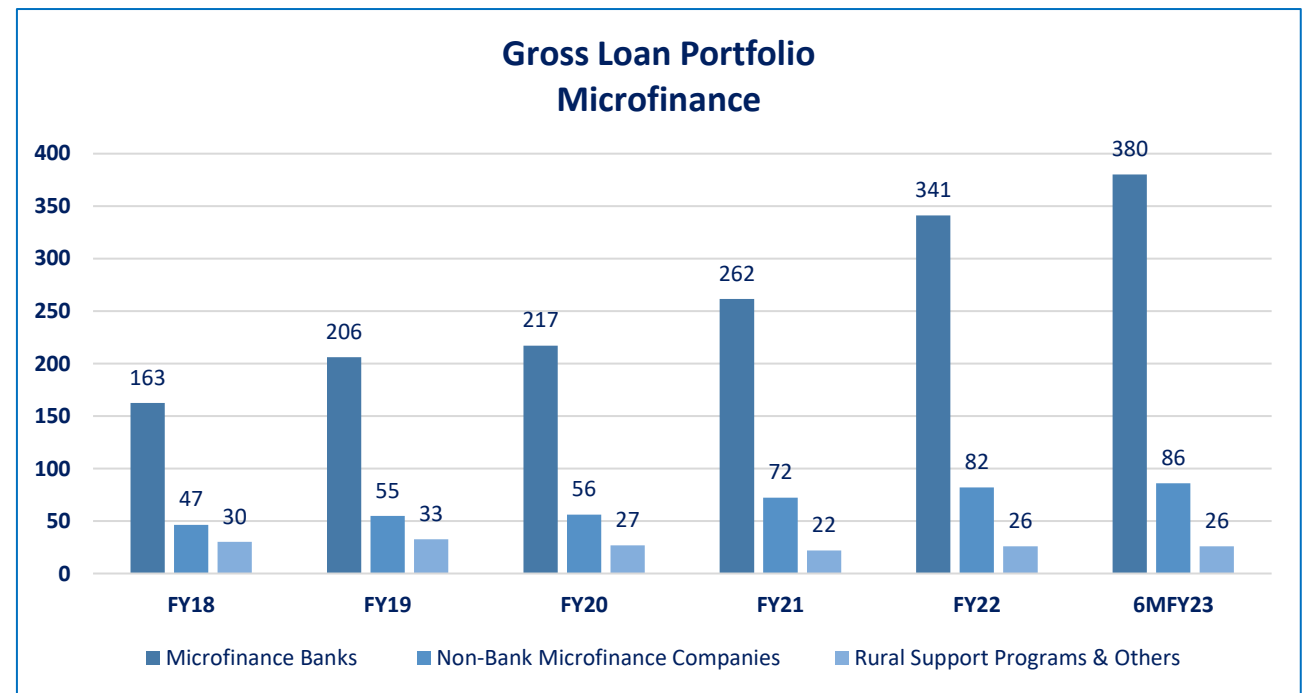


Modarabas & NBFCs

Non-Bank Microfinance Companies (NBMFCs) | An Overview

- Non-Bank Microfinance Companies (NBMFCs) hold the third highest weight by assets in the Modarabas & NBFCs sector contributing ~7% to the total assets of the sector.
- There are 35 licensed NBMFCs providing services in the country having assets worth of PKR~168bln, as at end of 1HFY23.
- The Gross Loan Portfolio (GLP) of Non-Bank Microfinance Companies was recorded at PKR~86bln at end of 1HFY23 (PKR~82bln during FY22) as compared to lending by Microfinance Banks of PKR~380bln at End-1HFY23 (PKR~341bln at end of FY22).
- The growth in economic activity in FY22 resulted in higher loan disbursement for the Non-Bank Microfinance Companies and a growing GLP.

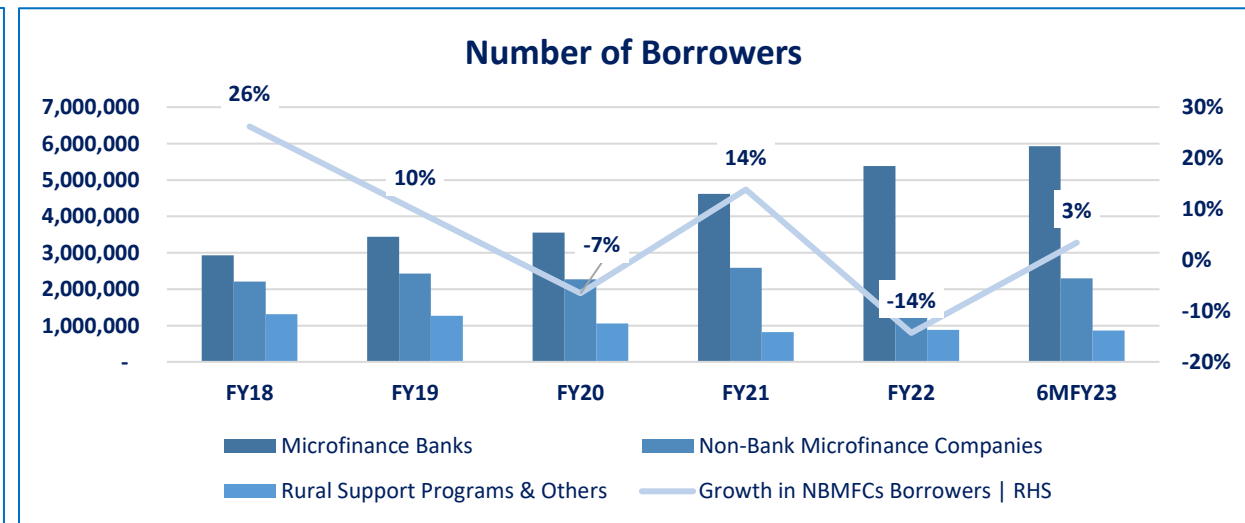
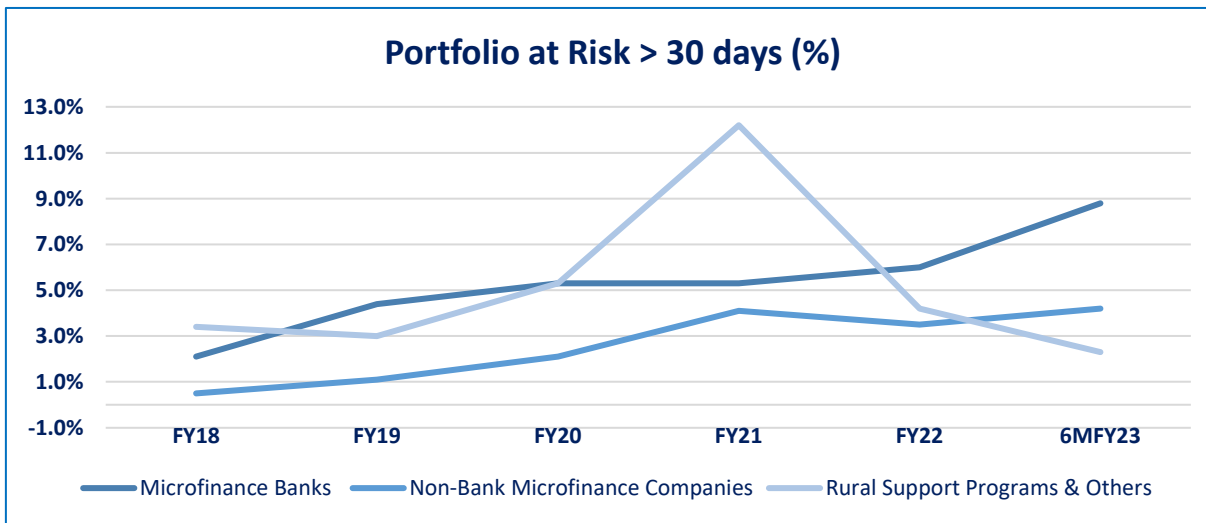
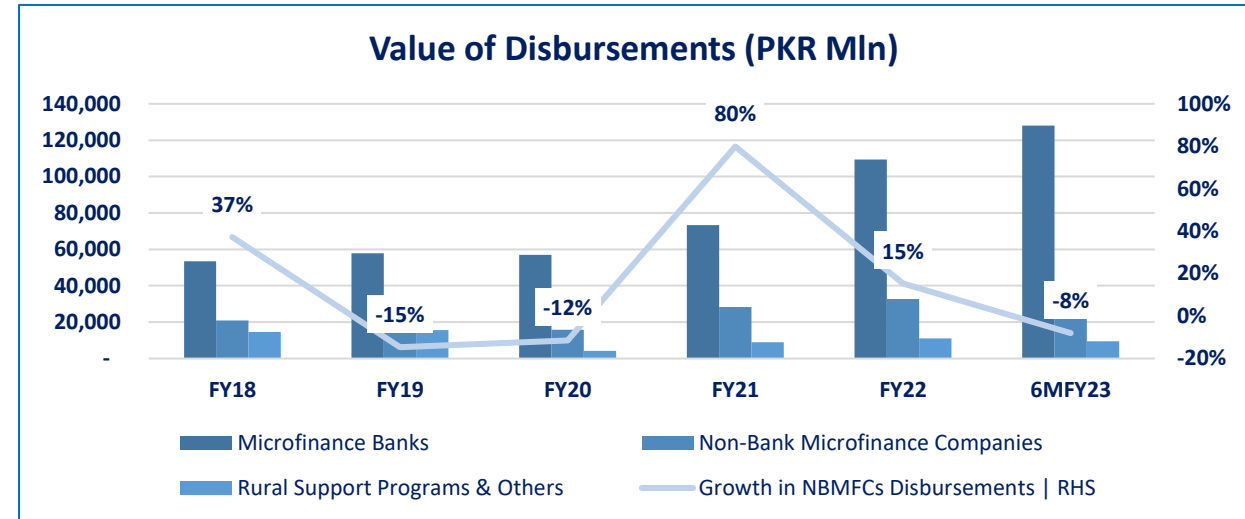
Total Assets (PKR bln)	FY18	FY19	FY20	FY21	FY22	6MFY23
NBMFCs	157	117	122	137	163	168



Modarabas & NBFCs

Non-Bank Microfinance Companies | Borrowers & Loan Sizes

- The number of borrowers of NBMFCs have increased from ~2.2mln in FY18 to ~2.3mln in 1HFY23 while the MFBs borrowers increased from ~2.9mln to ~5.9mln during the same period.
- NBMFCs' total disbursements decreased by ~8% in FY22 to reach PKR~30bln at End-1HFY23 as compared to PKR~128bln for MFBs, an increase of ~17% over 6 months.
- The percentage of portfolio at risk of NBMFCs has marginally increased from ~3.5% in FY22 to ~4.2% by End-1HFY23.



REITs/Trusts and Investment Banks | An Overview

- The scope of REIT companies was earlier restricted to the construction sector and real estate projects. However, in an effort to formalize the real estate sector of the domestic economy, the SECP has allowed REIT companies to raise financing from agriculture, mobile tower and renewable energy projects.
- The SECP has also allowed the establishment of REITs as general purpose investment funds. Operating like mutual funds, REIT service providers can now attract capital from investors to finance their REIT projects.
- In addition, the SECP has introduced REIT regulations in CY22 which define the eligibility rules for classifying an entity as a REIT company, general conditions for being classified as a REIT scheme, and rules for a public offering and listing of REIT units amongst other regulations.
- Real Estate Investment Companies (REITs)/Trusts and Investment Banks hold a ~7% and ~4% share, respectively, in the total assets of the Modarabas & NBFCs Sector.
- There are 16 Real Estate management companies, 11 Real Estate Trust (scheme) and 20 Investment Banks.
- The assets of three REITs (Dolmen City REIT, Silk Islamic Development REIT and Silk World REIT) worth PKR~67bIn (Dec'21) are currently offering units to investors. The collective asset base of all Investment banks was recorded at PKR~109bIn at the end of 1HFY23.

Assets (PKR bln)	FY18	FY19	FY20	FY21	FY22	6MFY23
REIT	42	46	49	54	98	168
Investment Banks*	58	63	65	68	91	109

*Includes Investment Banks which did not file online returns. Note. Total assets, total liabilities, equity and deposits, etc. of investment banks increased significantly in February 2018 mainly due to change of license status of one leasing company from leasing to investment finance services

Modarabas & NBFCs

Investment Banks | Asset Break-up and Financial Position

Asset Allocation of Investment Banks as of End-1HFY23

PKR bln	Cash & Bank	Investments	Loans & Advances	Lease	Investment Property	Operating Assets	Other Assets	Total
Investment Banks	5.9	26.1	44.0	12.7	0.5	4.8	13.8	113.7

Assets and Liabilities of Investment Banks as of End-1HFY23

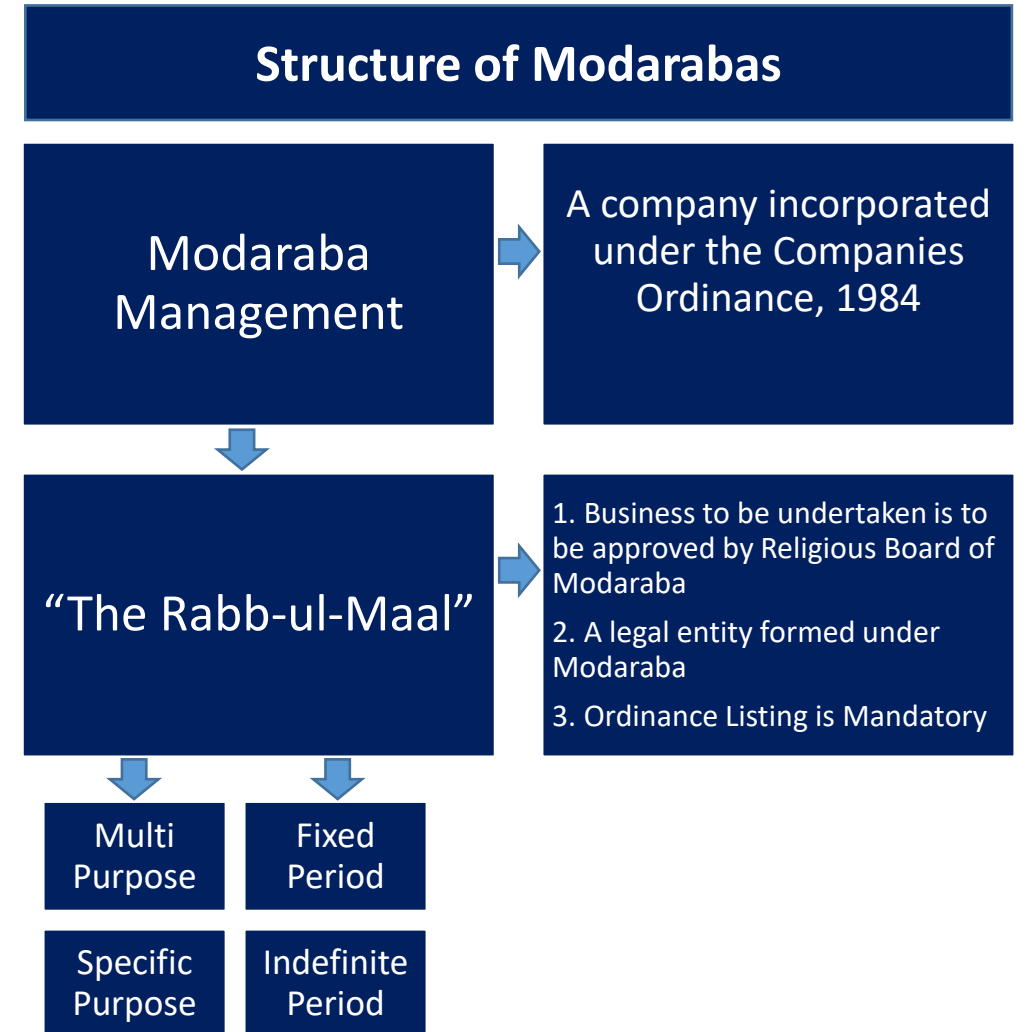
PKR bln	Equity	Liabilities	Total Assets	Equity as % of Total Assets	Liabilities as % of Total Assets
Investment Banks	42.7	63.5	107.8	39.6%	58.9%

Deposits as of End-1HFY23

Deposit Raising of Investment Banks	PKR bln
Individual	4.0
Corporate	0.5
Trust	0.3
Government Entities	0.0
Financial Institutions	0.0
Total	4.7

Note: Information pertaining to one Investment Banks is not included in above tables. Equity and liabilities do not include deficit/surplus on revaluation of fixed assets.

- A Modaraba is one of the prime modes of Islamic Financial System. In Pakistan Modarabas operate under a unique model with the following features:
- Modarabas are allowed to offer any financial product or conduct any business provided it is Shariah-compliant and approved by the Religious Board. Modarabas can invest in stock markets, trading of halal commodities, project financing activities etc.
- Modarabas can raise funds in the form of Certificates of Modaraba and Certificate of Musharaka. These can also issue Sukuk and Musharaka-based TFCs.
- Modaraba certificates required to be listed on the stock exchange for trading purpose.
- In multi-purpose Modarabas, transactions are based on Ijarah, Musharaka, Diminishing Musharaka, Murabaha, Musawama, Salam and Istisna, whereas specific purpose Modarabas are designed to handle nominated projects.



Modarabas & NBFCs

Modarabas | Assets

- There are a total 27 Modarabas operating within the country.
- The total assets of Modarabas have increased from PKR~53bln in FY18 to PKR~65bln at the end of 1HFY23.
- ~39% of the total assets are tied up in loan & advances to customers.

Modarabas (End-1HFY23)	Deposits (PKR bln)
Individual	2.3
Corporate	2.1
Trust	1.2
Government Entities	0.0
Financial Institutions	12.7
Total	18.3

Total Assets (PKR bln)	FY18	FY19	FY20	FY21	FY22	6MFY23
Modarabas	52.9	53.4	51.4	54.4	61.5	65.3

Assets & Liabilities as of End-1HFY23

PKR bln	Equity	Liabilities	Total Assets	Equity as % of Total Assets	Liabilities as % of Total Assets
Modarabas	25.9	37.4	65.3	39.6%	58.9%

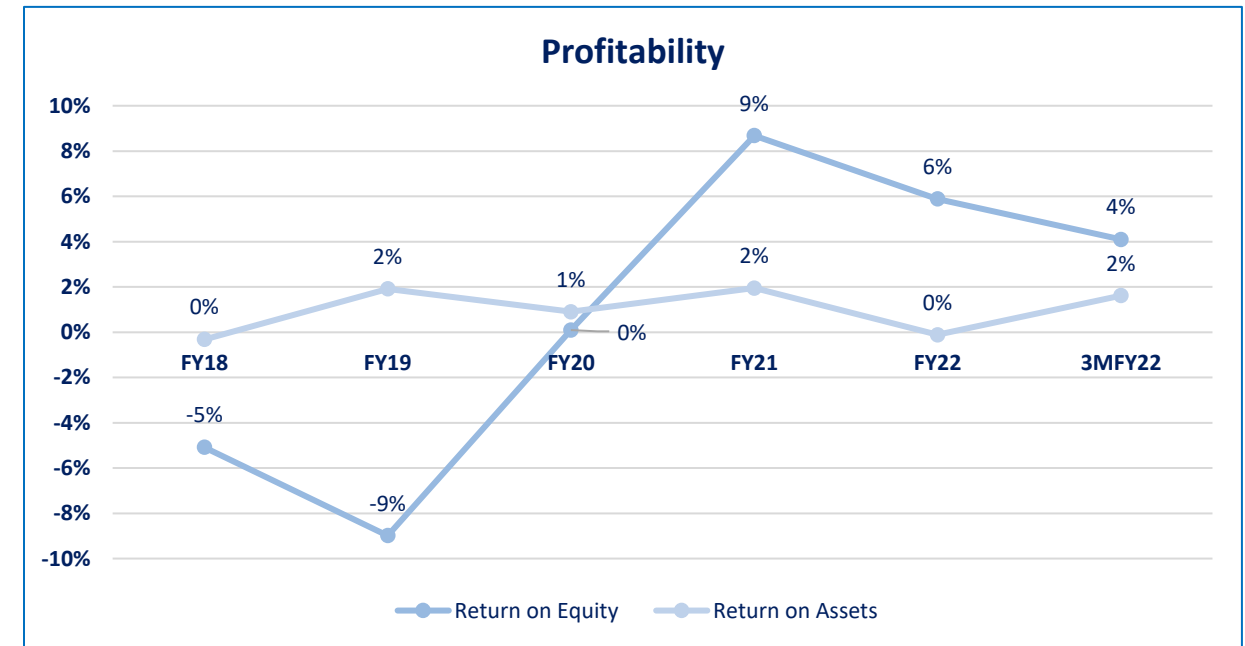
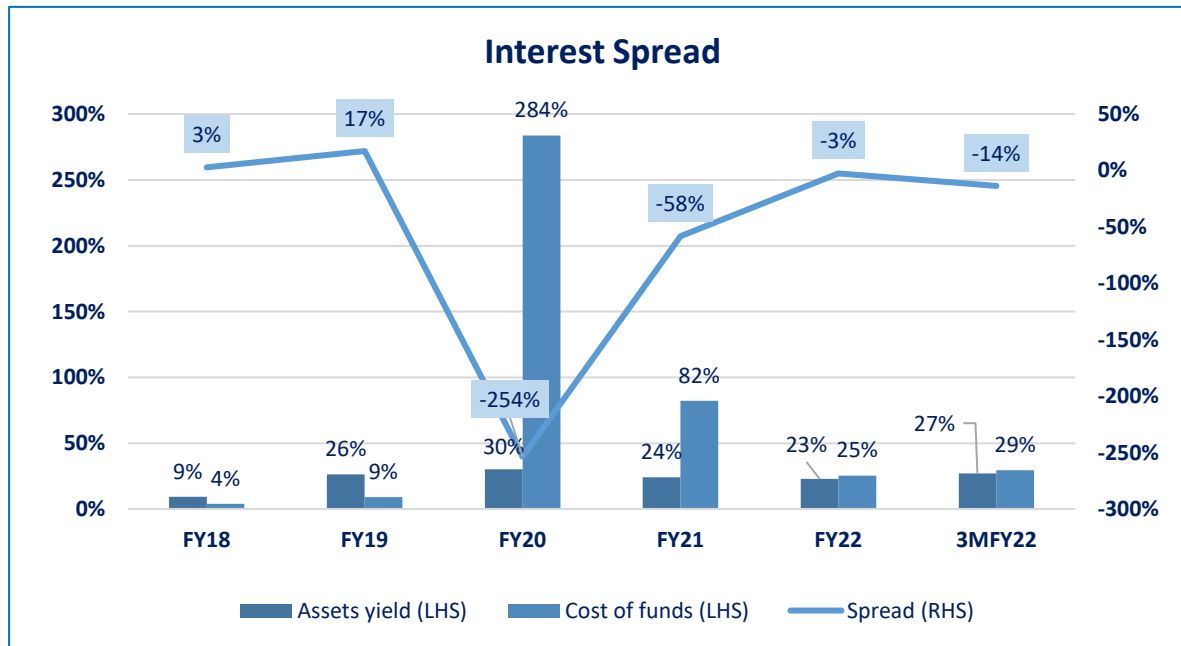
Asset Allocation as of End-1HFY23

PKR bln	Cash & Bank	Investments	Loans & Advances	Lease	Investment Property	Operating Assets	Other Assets	Total
Modarabas	2.4	5.6	25.8	2.7	1.0	16.3	11.6	65.4

Modarabas & NBFCs

Modarabas | Profitability

- The interest spread has decreased from ~17% in FY19 to ~-3% in FY22. This decrease can be attributed to higher cost of funds which has increased from ~9% in FY19 to ~25% in FY22.
- Lower interest spread also translated into lower return on equity and return on asset in FY22 which were recorded at ~6% and ~0% respectively as compared to ~9% and ~2% in FY21.



Modarabas & NBFCs

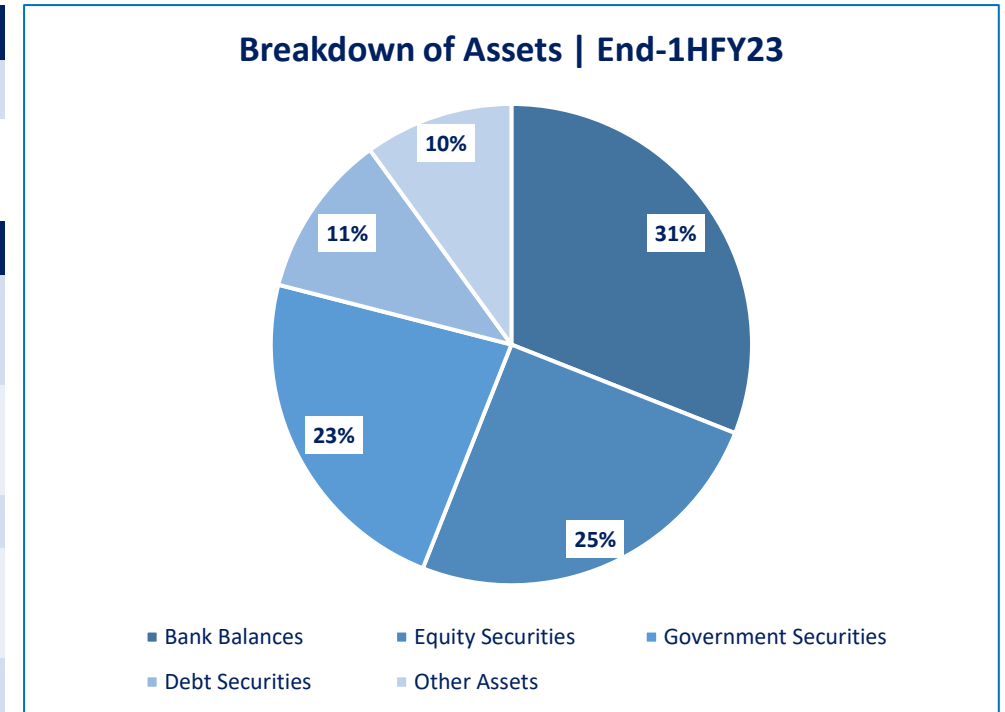
Pension Funds | An Overview

- Pension Funds are also an integral part of the NBFC Industry of Pakistan and hold ~2% share of total assets with an asset base of PKR~44bln as at End-1HFY23 (PKR~27bln in FY18).
- ~64% of the total pension fund is Shariah-compliant while ~36% consists of conventional funds. ~25% of the total pension fund is invested in equity market to hedge against growing inflation while ~34% is invested in debt and other fixed income government securities to reduce portfolio downside risk.

Total Assets (PKR bln)	FY18	FY19	FY20	FY21	FY22	6MFY23
Pension Funds	27	27	31	40	42	44

Shariah Compliant vs. Conventional Pension Funds

Description (PKR bln)	FY18	FY19	FY20	FY21	FY22	6MFY23
Shariah Compliant Pension Funds	17	17	20	26	27	28
Conventional Pension Funds	10	10	11	14	15	16
Total Assets	27	27	31	40	42	44
Share of Shariah Pension Funds	64%	64%	64%	65%	65%	64%
Share of Conventional Funds	36%	36%	36%	35%	35%	36%



Modarabas & NBFCs

Leasing Companies & Private Equity | An Overview

- Leasing Companies and Private Equity/Venture Capital Funds have ~1% of total assets share in Modarabas & NBFCs.
- They hold PKR~6bln and PKR~12bln worth of assets, respectively.
- There are 4 leasing companies and 14 Private Equity/VC funds currently operating in the country.
- Total assets of Leasing companies have declined from PKR~10bln in FY18 to PKR~6bln in 1HFY23.

Assets (PKR bln)	FY18	FY19	FY20	FY21	FY22	6MFY23
Leasing Companies	10	10	11	5	6	6
Private Equity & VC	5	7	7	7	11	12

Assets & Liabilities as of End-1HFY23

PKR bln	Equity	Liabilities	Total Assets	Equity as % of Total Assets	Liabilities as % of Total Assets
Leasing Companies	1.9	4.0	6.0	32.4	66.0

Modarabas & NBFCs

Regulatory Framework

The Sector Structure of Modarabas & NBFCs as per SECP is divided in two Clusters:

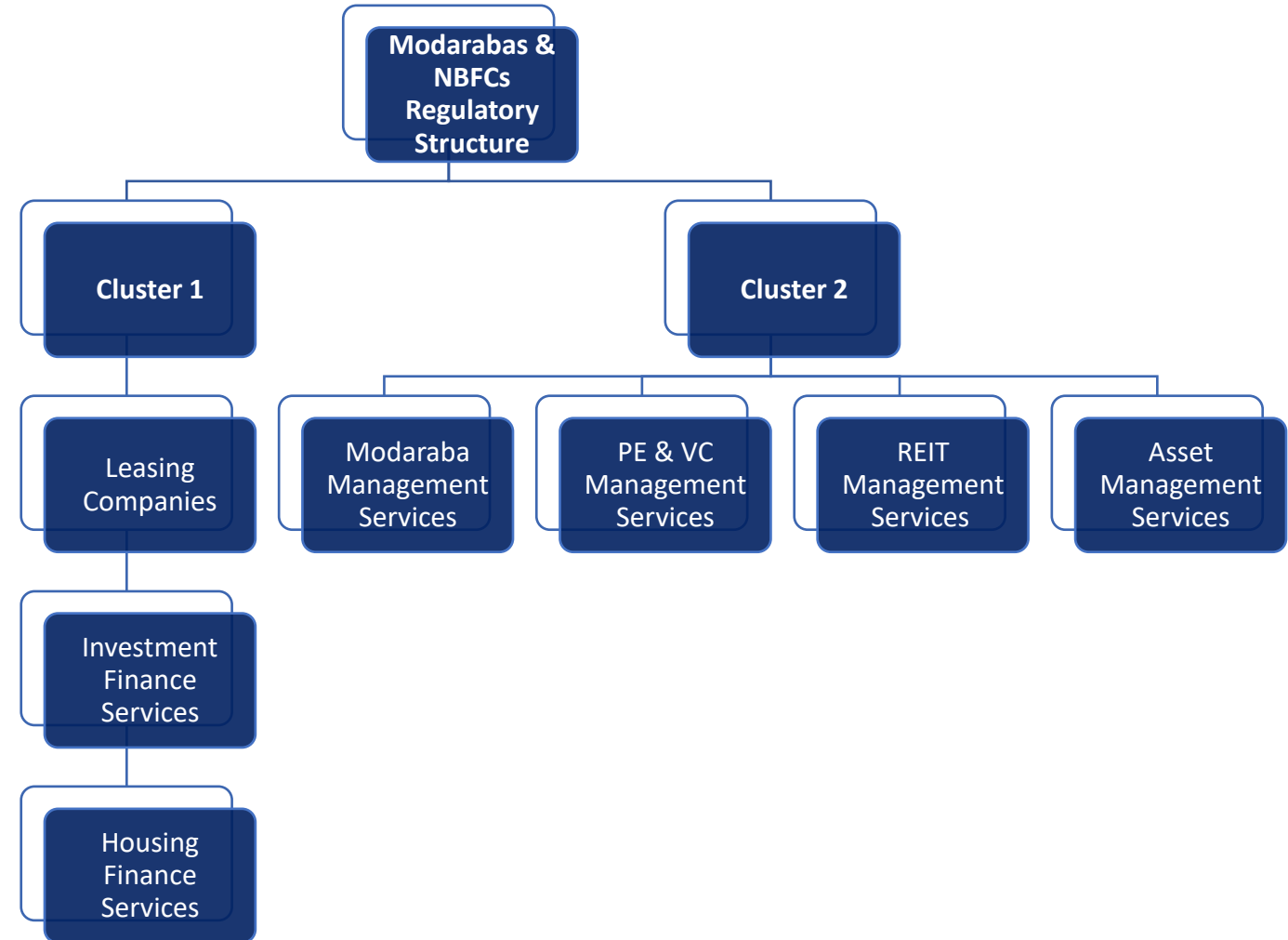
- Cluster 1 is for non-banking financial services
- Cluster 2 is for fund management services.

In Pakistan, following are the Relevant Laws with regards to **NBFCs**:

- The Companies Ordinance, 1984 (282A- 282 K)
- The Non-Banking Finance Companies and Notified Entities Regulations, 2008
- The Non-Banking Finance Companies (Establishment and Regulation) Rules, 2003

Modarabas are observing all laws and regulations promulgated in the following:

- Modarabas Ordinance, 1980 (updated 2012)
- Prudential Regulations for Risk Management and Conducting day to day Affairs (updated 2008)
- Shariah Compliance and Shariah Audit Mechanism 2012 (SCSAM)



Modarabas

- The tax exemption benefit which was provided on the income of the modaraba sector upon the distribution of 90% or more income as dividends has been withdrawn in FY21.
- For trading Modarabas, the maximum tax rate is 25%

Mutual Funds

- Capital Gain Tax on mutual fund, if dividend receipts of the fund are more than capital gains is 10% (20% for non-filer) otherwise it is 12.5% (15% for non-filer). Capital gain is exempt if units are held for more than 6 years.
- Dividend Income received from a mutual fund is taxed at 15%.
- Unit holders of the mutual funds are entitled to tax credit, the amount on which is lower of (a) amount invested in purchase of new units, (b) 20% of the taxable income of the unit holder, or (c) PKR 1 million, and is calculated by applying average rate of tax of unit holder for the tax year.

REITs

- Income of REIT has been exempted from tax if 90% of the profit is distributed.
- The tax rate on dividend income from REIT scheme has is 35% Gain arising on disposal of immovable property to development and residential REIT is exempt up to 2023.

Pension Fund

- The accumulated balance of up to 50% received from a pension fund at the time of an eligible person's retirement, disability or death is exempt from tax. Any profit or gain or benefit derived by a pension fund manager from a pension fund on redemption of the seed capital invested in the pension fund is also exempt from tax.

Venture Capital Fund

- Venture Capital companies/funds have Income tax holiday till June 30, 2024, under Venture Capital Companies and Funds Management Rules, 2000. Dividend income and long-term capital gains of a venture capital undertaking from investments in zone enterprises, are exempt from Income tax for 10 years commencing from issuance of license.

Latest Developments

- The SECP has issued a procedural guide on the formation and licensing of non-banking finance companies (NBFCs) which provides comprehensive information on the procedure for formation, incorporation and licensing of NBFCs.
- The SECP has issued the following revisions in regulations:
 - i. Asset management companies should have appropriate policies and procedures in place which govern the trading or investment activities by its employees.
 - ii. Asset management companies managing a collective investment scheme must, within fifteen days of the close of every calendar month of the Collective Investment Scheme, pay the SECP a non-refundable fee. This fee will be a percentage of the average net assets of the Collective Investment Scheme as provided In the schedule.
 - iii. NBFCs engaged in lending (including by digital means) must adequately and accurately disclose offered products, services, applicable terms and conditions to borrowers, customers, and other stakeholders.
 - iv. Deposit-taking NBFCs shall comply with stated margin requirements while non-deposit taking NBFCs shall determine their own margin requirements on facilities provided by them to their borrower after considering the risk profile of the borrower.
- Furthermore, in order to address complaints of mis-selling, inflated charges and undue access to customer data, the SECP has imposed a number of regulations which include:
 - a. Restrictions on deducting upfront charges from the lent amount.
 - b. Restricting lending companies from operating more than one digital lending app and while only permitting them to launch different products and schemes under one app.
 - c. Maintaining confidentiality of data on digital lending apps and provide audit reports of their apps to from a PTA-approved IT security audit firm.

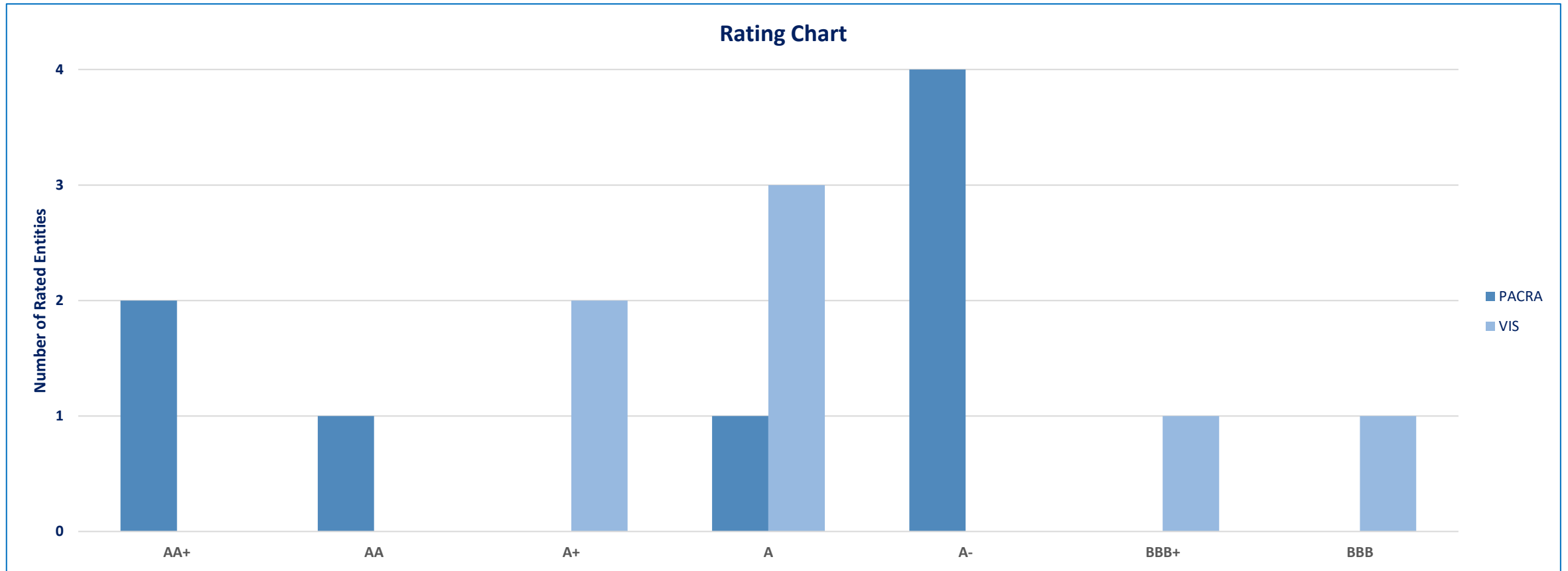
Latest Developments

- Clear disclosure of loans terms and conditions, requirements of managing credit risk, advertisements, grievance redressal systems and loan collection methods.
- Prohibiting a change in loan terms agreement without the prior consent of the borrower.
- Furthermore, to facilitate the mutual fund industry and protect investor's interest, SECP has taken the following initiatives:
 - a. Prescribed new eligibility requirements to register as trustee of open end or closed end schemes.
 - b. Prescribed regulatory framework for Fixed Rate Mutual Fund which will contribute towards expanding investor base and leads to availability of a low-cost investment product.
 - c. Prescribed regulatory framework for account opening by Asset Management Companies (AMCs) to promote digitization and micro-savings and allowed Roshan Digital Account (RDA) eligible banks to distribute units of CIS/VPS of multiple AMCs without obtaining license.
 - d. SECP has proposed reforms to the NBFC Rules 2003, to eliminate regulatory bottlenecks by introducing the concept of perpetual licensing, reducing documentation requirements, removing multiple regulatory approvals and allowing the group companies to undertake different business activities under one license.
 - e. NBFC Regulations 2008 have been amended to introduce improved governance structure, liquidity & risk management requirements for non-banking microfinance companies and credit underwriting standards for housing finance and allowed premature redemption of Certificate of Deposits (CODs) by deposit taking NBFCs.

Latest Developments

- f. Facilitated inclusion of NBMFCs as executing agency for Kamyab Pakistan Program and housing finance companies in Government mark-up subsidy scheme, for housing finance
 - g. The Government has approved Non-Banking Finance Companies Bill, 2021, which provides a modernized, dedicated and consolidated parent regulatory framework for the NBFC sector. It will enhance growth, provide facilitation, innovation and overall strengthening of the NBFC sector coupled with stronger governance and investor protection mechanisms.
- The 2022 finance bill introduced the following taxation measures with respect to the sector:
 - a. In the case of Modarabas, a 25% rate of income tax will be applied to the total income with some notable exemptions.
 - b. Any capital gains distribution received by a taxpayer from a collective investment scheme is exempt from taxation. This exemption is only available to mutual funds, collective investment schemes that are debt or money market funds and these do not invest in shares.
 - c. Tax credits and deductible allowances with respect to investment in mutual funds have been withdrawn.
 - d. Previously, in respect of Mutual Fund or Collective Investment Scheme or a REIT scheme, no capital gains tax was deductible if the holding period of the security was more than 4 years. This holding period has now been increased to 6 years.
 - e. There has been a withdrawal of tax exemptions with respect to the receipt of monthly installment from an income payment plan invested outside of accumulated balance of specified individual pension accounts or approved annuity plan.
 - f. In addition, amount in excess of 50% contributions to an approved gratuity, pension and superannuation fund will be an inadmissible expense in computing the income from business.

Rating Chart



Modarabas & NBFCs

SWOT Analysis

- Organized Sector with listed players.
- Major share in lending to SMEs
- Offers smaller investors access to professionally managed and diversified portfolios.
- There is large variety of fund and investor who can make choices according to their specific objectives.

- Mainstream banks have the might to take away business.
- Market Risks
- Asset Quality Deterioration for Small Lenders in times of crisis.
- Uncertainty in market and amongst investors due to inflation and rising commodity prices in International market due to Russia-Ukraine Conflict.



- Slow growth rates
- High Management Fees
- Lack of awareness for potential investors and borrowers
- Low financial inclusion

- Ample room to grow.
- Introduction of new products, such as Exchange Traded Funds.

Outlook: Stable

- In the overall economy, NBFCs have emerged as an alternative to conventional banking system and are playing a crucial role by providing sources of funding to sections that are not covered by conventional banks (Infrastructure, micro, SMEs, etc.). NBFCs are therefore, now integral for the economic development and increase in financial inclusion of the country. Considering the GDP growth forecasts for the upcoming year, the need for credit will increase more than proportionately. In recent past also, NBFCs have witnessed considerable growth in total assets from PKR~1,228bln in FY18 to PKR~2,563bln in 1HFY23.
- NBFCs raise funds mostly from mobilizing deposits. Given the rate sensitivity of NBFCs' liabilities and asset liability mismanagement, it becomes difficult to price and tenor term loans. Besides financing issues, operational problems for NBFCs emanate from limited outreach and inability to tap a niche market when the high-end of the market is largely served by commercial banks. As interest rates have climbed from 15.0% in Aug'22 to 21.0% as of now (Mar'22), NBFCs can witness narrowing of spread and net interest margin.
- **Mutual Funds:** The mutual funds segment accounted for the largest chunk of total assets of the Modarabas & NBFCs sector (~61.0%). In FY22, the mutual fund industry celebrated crossing the PKR~1.3trn assets under management mark. This growth is partly attributable to the recent requirement for scheduled commercial and Islamic banks to maintain an Advance to Deposit Ratio (ADR) of over 50% by December 31, 2022, an effort to discourage banks from investing in government securities and encourage lending to the real economy. However, with lending in a high interest rate environment becoming extremely challenging, banks have started to shed their high-cost depositors which has paved the way for mutual funds to expand their reach and market share. In addition, diversity in product mix, uptick in financial literacy and competitive returns have increase demand for this product.
- During FY22, the stock market exhibited a negative trend as political and economic factors and uncertainty halted the FY21 success, wherein the KSE-100 index posted a return of ~39%. Consequently, the average KSE-100 index return in FY22 was ~0%. The market slightly recovered in the 7MFY23 period and the index posted a return of ~3% on account of renewed hopes of the approval of a much awaited USD 1.1bln IMF loan tranche.

Outlook: Stable

- **Venture Capital/ Private Equity Firms:** The venture capital or private equity segment is at a nascent stage in Pakistan. As at the end of 1HFY23, the sector accounted for ~1% of aggregate assets of the Modarabas & NBFCs sector. Inadequate institutional support, lack of appropriate tax incentives and limited exit options is the reason for sluggish growth of venture capital market in Pakistan.
- **Leasing Companies:** There are a number of players actively engaged in providing lease financing in Pakistan. Competition has intensified as the demand for lease finance has increased on account of high economic growth that raised the demand for credit, low interest rates that enhanced the affordability of leasing as a mode of financing for small enterprises as well as individuals; and introduction of shariah-compliant leasing. The leasing sector's assets stand at PKR~6bln as of End-1HFY23 staying relatively constant from the FY22 level. As the high interest rate regime gradually sets in, there will be a consequent squeeze on the spread and interest margin of leasing companies. The leasing companies face stiff competition from commercial banks due to which these have sought to diversify their businesses.
- **Modarabas:** The withdrawal of the tax exemption benefit on the distribution of 90% or more income to certificate holders as dividends which became effective in FY21 will pressurize profitability and may impacts issuance of certificates in the future.
- The policy rate has also been revised upwards in successive reviews and now stands at 21.0%. There is a likelihood that this tightening effort continues in the short- to medium-term as Pakistan struggles to bring inflationary pressures under control (Average CPI in 8MFY23: 27.2% vs. 10.7% in SPLY).
- Concurrently, the yields on T-Bills and PIBs have also witnessed significant increases following revision in the policy rate. As interest rates are climbing upwards, Modarabas & NBFCs can witness narrowing of spreads and net interest margins in the near future.

BIBLIOGRAPHY

- Financial Stability Board
- World Bank
- International Monetary Fund
- Planning Commission of Pakistan
- Pakistan Innovative Finance Forum (Karandaaz)
- NBFI Association of Pakistan
- SECP
- GOP Finance Division, Economic Adviser’s Wing
- Pakistan Stock Exchange (PSX)
- State Bank of Pakistan (SBP)
- Federal Board of Revenue (FBR)
- PACRA Database

Research Team	Saniya Tauseef <i>Manager PACRA Research</i> saniya.tauseef@pacra.com	Ayesha Wajih <i>Supervising Senior PACRA Research</i> ayesha.wajih@pacra.com	Nida Naguib <i>Senior Research Analyst PACRA Research</i> nida.naguib@pacra.com
Contact Number: +92 42-35869504			

DISCLAIMER

PACRA has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. The information in this document may be copied or otherwise reproduced, in whole or in part, provided the source is duly acknowledged. The presentation should not be relied upon as professional advice.