



**Materiality Policy  
For  
Funds Under Management**

## Materiality Policy for Funds under Management

### **Requirement**

This policy has been developed pursuant to the provisions of clause 5.19.4 (vii) of the Rule Book of Pakistan Stock Exchange Limited under the code of corporate governance. Clause 5.19.4 bears the heading *‘Responsibilities, Powers and Functions of Board of Directors’* and its sub-clause (viii) is reproduced herein below (hereinafter referred to as the “subject clause”):

*“the board of directors shall define the level of materiality, keeping in view the specific circumstances of the company and the recommendations of any technical or executive subcommittee of the board that may be set up for the purpose.”*

### **Historical background**

The Mutual Funds ("the Funds") have no actual board of directors or an independent management mechanism by which a materiality policy can be generated, however, they as per law are operated by their asset management companies and governed by its Board, nonetheless, funds have to comply with the Code by virtue of being listed entities.

In relation to the above, it would appear that the term ‘materiality’ relates to materiality of a transaction which would form the schedule of matters that the board of a company is to consider regularly.

### **Purpose**

This policy defines the level of materiality for the matters that require appropriate disclosure and approvals of the Board of Directors of the Management Company of the Funds.

### **Guiding Factor**

As the requirement for determination of level of materiality is stipulated in the Code of Corporate Governance (“CoCG” or “the Code”) hence this should be assessed first that how and in what manner the materiality is used in the Code.

The Code uses the word “material” and “materiality” in the following contexts

1. Where the Board of directors is required to generally determine the nature or amount of transactions that would be considered material;
2. Where the Code itself specifies the level of materiality with reference to particular issues and only requires that such issues be decided by the directors; and

3. Where the materiality of a transaction is required to be specifically determined by the Company, directors, or the management on a case by case basis.

## **Policy**

Considering the requirements of the Code the levels of materiality being sought to be defined by the board of directors of a listed company relate mainly to the following matters:

- Investments,
- Cases of bribery, fraud, corruption or irregularities of a material nature
- Failure to recover a material amount of trade debts, loans and advances and deposits
- Lawsuits of material nature
- Disclosure of material information to stock exchange

## **Limitations**

The structure of the Funds is significantly different with other listed companies, contrary to the other companies all affairs of the funds are extensively regulated, specific parameters, governing rules, exposure limits, expenses to be borne by funds, investment restrictions etc. are explicitly given in NBFC Rules 2003 ("the Rules") and NBFC Regulation 2008 ("the Regulations") along with constitutive documents of the funds.

The restrictions and limitations on the AMC and the funds under its management includes but not limited to the following:

**Regulation 55 of the Regulations explain Investment Policy and diversification of Collective Investment Scheme in details. Excerpts of the regulation is stated below for reference**

- i. *A Collective Investment Scheme shall not invest in Unlisted Equity Securities unless an application for listing of such securities has been accepted by the stock exchange: Provided that a Collective Investment Scheme may make total investments in a pre-initial public offering (Pre-IPO) up to fifteen percent of its net asset value, subject to the investment limits prescribed under these Regulations.*
- ii. *Exposure of a Collective Investment Scheme to any single entity shall not exceed an amount equal to ten per cent of total net assets of the collective investment scheme, subject to following conditions:*
  - a. *Exposure to equity securities of a company shall not exceed ten percent of the issued capital of that company;*
  - b. *Exposure to any debt issue of a company shall not exceed ten percent of that issue. [Provided that subject to the conditions prescribed in clauses (a) and (b) above the exposure of an equity scheme to any single entity shall not exceed an amount equal to ten per cent of the net assets of the Scheme or the index weight of the security subject to the limit of fifteen percent, whichever is higher.]*
- iii. *Exposure limits for following types of schemes shall be lower of net assets of a scheme or issued*

iv. securities of a company:

<b>Type of Scheme (Fund)</b>	<b>Maximum limit (Equity Securities)</b>	<b>Maximum limit (Debt Securities)</b>
<i>Shariah Compliant/Islamic Fund</i>	15%	15% of single issue
<i>Index Funds (tracking recognized or approved index or its subset)</i>	<i>weight of security in the index or its subset</i>	<i>weight of security in index or its subset</i>
<i>Sector specific fund</i>	20%	20% of a single issue
<i>Capital Protected Fund or Guaranteed Fund</i>	<i>Per company limit as specified in sub regulation (5) shall not apply to such percentage of assets of the scheme that is placed with a bank or invested in such a manner that it will become 100% at maturity of the scheme/fund or a guarantee has been obtained from the bank for guaranteed fund</i>	
<i>Fund of funds</i>	<i>No limit; Provided that the Asset Management Company shall not charge management fee if the fund invests in the schemes managed by the same Asset Management Company.]</i>	

- v. An Asset Management Company shall not invest more than twenty five per cent of total net assets of the Collective Investment Scheme in securities of any one sector as per classification of the stock exchange, provided that the following types of schemes shall follow the limits specified below:

<b>Type of Scheme (Fund)</b>	<b>Maximum Per Sector limit</b>
<i>Equity Funds</i>	<i>30% or index weight whichever is higher, subject to maximum of 35%</i>
<i>Shariah Compliant/Islamic Fund</i>	<i>35% or index weight, whichever is higher, subject to maximum of 40%</i>
<i>Index Funds (tracking recognized or approved index or its subset)</i>	<i>Weight of sector in the index or its subset</i>
<i>Sector specific fund</i>	<i>No limit</i>
<i>Fund of funds</i>	<i>No limit; Provided that the Asset Management Company shall not charge management fee if the fund invests in the schemes managed by the same Asset Management Company.</i>
<i>Capital Protected Fund or Guaranteed Fund</i>	<i>No limit; Provided that such percentage of assets of the scheme is placed with a bank or invested in such a manner which will become 100% at maturity of the scheme or a guarantee has been obtained from the bank for guaranteed funds</i>

- vi. An Asset Management Company, on behalf of Collective Investment Scheme, shall not take Exposure of more than:

- a. *thirty five per cent of net assets of Collective Investment Scheme in any single group; and*  
*Explanation: For the purpose of Regulation 55(10)(a) “group” means persons having at least 30% common directors or 30% or more shareholding in any other company, as per publicly disclosed information;*
- b. *ten per cent of net assets of collective investment scheme in listed group companies of the asset management company and such Exposure shall only be made through the secondary market.*
- vii. *Where the Exposure of a Collective Investment Scheme exceeds the limits specified in sub-regulation (5), (6) or (9) of this regulation because of corporate actions including taking up rights or bonus issue or due to market price increase or decrease in net assets due to redemption the excess Exposure shall be regularized within four months of the breach of limits.]*
- viii. *The exposure limits prescribed under sub-regulation (10) of Regulation 55 will not be applicable for Index Funds, Capital Protected Fund and Fund of Funds or any other category as specified by the Commission]*
- ix. *A Collective Investment Scheme may invest only in securities, commercial papers, deposit with Financial Institutions, place funds with financial institutions, or invest in any other avenues as approved by the Commission from time to time.*
- x. *The exposure limits prescribed under sub-regulation (5), (6), (9) and (10) of this regulation will not be applicable in case of exposure in securities issued by the Federal Government i.e. PIBs, TBs, Government Ijara Sukuks.]*

Apart from the above restrictions and limitation on an AMC with regards to investments with regards to CIS under management, the Regulation 37(2) of the NBFC Regulations also provides for the requirement of at least one investment committee or several for various classes of assets to be constituted and approved by the AMC for the purposes of management of the fund. Further, Regulation 37(3) of the NBFC Regulations provides a list of requirements that such investment committee is to fulfil. In particular regulation 37(3)(h) of the NBFC Regulations provides for the development and follow up of internal. Accordingly an investment Committee has been formed in the company which operates within the guidelines given in the Regulations.

**In addition to the above Regulations 60 deals with the expenses chargeable to Collective Investment Scheme. Excerpts of the regulation is stated below for reference**

- (3), *the following fees and charges shall be payable from the Collective Investment Scheme, -*
  - i. *remuneration of the Asset Management Company;*
  - ii. *remuneration of trustee or custodian;*
  - iii. *in case of an Investment Company, the directors fees and related expenses for attending meetings;*
  - iv. *listing fee payable to the stock exchange, including renewals;*
  - v. *charges and levies of stock exchange, national clearing and settlement company and*

- central depository company;*
- vi. rating fee of Collective Investment Scheme payable to approved rating agency;*
- vii. auditors' fees and out of pocket expenses as billed by them;*
- viii. fees payable to the Commission;*
- ix. formation cost of the Collective Investment Scheme not exceeding one per cent of the pre-initial public offering capital in case of an Open End Scheme and one percent of the paid-up capital in case of a Closed End Fund or five million rupees whichever is lower;*
- x. brokerage and transaction costs related to investing and disinvesting of the assets of the Collective Investment Schemes;*
- xi. expenses incurred by trustee in affecting registration of all registerable assets in the name of the trustee;*
- xii. legal and related costs incurred in protecting the interests of the unit, certificate or shareholders of the Collective Investment Scheme;*
- xiii. bank charges, borrowing and financial costs;*
- xiv. hedging costs including forward cover, forward purchase or option purchase costs;*
- xv. printing costs and related expenses for issuing the quarterly, half-yearly and annual reports, etcetera of the Collective Investment Scheme;*
- xvi. 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 overseas;*
- xvii. in case of Investment Company, printing and distribution of notices of meetings;*
- xviii. any other expense or charge as may be allowed by the Commission.*
- xix. fees and expenses related to registrar services, accounting, operation and valuation services related to CIS maximum up to 0.1% of average annual net assets of the Scheme or actual whichever is less;*
- xx. Shariah advisory fee; and*
- xxi. custody and insurances costs relating to the safekeeping of the physical gold in the vault(s) for Commodity Funds*

**Moreover, the Regulation 59 deals with the transaction with connected persons and employees. The relevant extract of the regulation is reproduced below.**

- i. An Asset Management Company on behalf of a Collective Investment Scheme shall not without the approval of the 2[its Board of Directors] in writing 3[and consent of Trustee], purchase from, or sell any securities to any connected person or employee of the Asset Management Company: Explanation: Regulation 59(1) shall not apply to the issue, sale or redemption of units or shares or certificates issued by the Collective Investment Scheme.*
- ii. Where cash forming part of assets of Collective Investment Scheme is deposited with the trustee or the custodian that is a banking company or an NBFC, a return on the deposit shall be paid by such trustee or custodian at a rate that is not lower than the rate offered by the said banking company or NBFC to its other depositors on deposits of similar amount and maturity.*
- iii. All transactions with connected persons carried out by an Asset Management Company on behalf of the Collective Investment Scheme shall be in accordance with the provisions of the Constitutive Documents and shall be disclosed in the annual report of the Collective Investment Scheme.*
- iv. An Asset Management Company may undertake transactions involving sale and purchase of securities between the Collective Investment Schemes managed by it where the:-*

- a. Sale and purchase decisions are in the best interest of the Schemes involved;
- b. Transactions are executed on an arm's length and fair basis; and
- c. Rationale for undertaking such transactions is documented prior to the execution

**The AMCs are also restricted vide Regulation 63 in distribution among unit holders on behalf of CIS. The extract of regulation is appended below for reference.**

*An Asset Management Company on behalf of a Collective Investment Scheme shall, for every accounting year, distribute by way of dividend to the unit holders, certificate holders or shareholders, as the case may be, not less than ninety per cent of the accounting income of the Collective Investment Scheme received or derived from sources other than capital gains as reduced by such expenses as are chargeable to a Collective Investment Scheme under these Regulations.*

In the presence of very well defined structure and limited sphere of operations apparently there is no room available for the management company and its board to determine materiality level or specific threshold with regards to the funds under its management.

## **Proposal**

In addition to the statutory provisions and the restrictions explained above the Board has also delegated certain powers to the Committees of the Board and all such matters falls under the terms of reference of the Committees shall also be routed to the Board upon recommendation of the respective Committees.

The Board of Directors also approves the annual business plan and budget each year comprising of projected revenues, expenses, capital expenditures etc.

In the light of the explanation given above following materiality threshold for the funds under management are further proposed.

- i. Any variation of 25% of the net assets of funds under management, if not already covered in constitutive documents or laws of Pakistan, besides unit transactions and valuation change of investments.
- ii. The split or merge of units, if any
- iii. Cases of fraud, bribery, corruption or irregularities without any limit;
- iv. Status and implications of law suits or proceedings by or against the Fund exceeding 15% of Nets Assets. However, all cases of defamation or reputational damage without any limit.
- v. Ratification of the decision of suspension of redemption of units during extraordinary circumstances.

All transactions which otherwise are required to be placed before the Board shall be approved by the directors without any limit. The transactions which are to be approved by the unit holders only shall be treated as material for the purpose of this policy.