Non-Bank Financial Institutions 6.2

Despite challenging macro financial conditions, non-bank financial institutions (NBFIs) demonstrated financial and operational resilience and exhibited higher growth than the previous year, primarily contributed by the asset management segment. In the wake of weakened economic activity and elevated interest rates, low-risk debt markets continued to remain the preferred avenue for the investors of asset management segment. However, the lending segment grappled with the impacts of stressed macro-financial conditions and posted only a muted growth during the year under review. Going forward, the performance of NBFIs will depend upon the evolving domestic and geopolitical economic conditions.

6.2 Non-Bank Financial Institutions

Non-Bank Financial Institutions (NBFIs)[1] sector and its wider ranging financial services hold a key significance for an economy. Although, the financial system in Pakistan is bank-centric with the NBFIs sector constituting only 5.8 percent in the asset base of the financial system, it has been growing at a steady pace over the years and providing some key non-bank financial services to the economy.

The NBFIs operated in an elevated interest rate environment in CY23 amidst multi-decade high inflationary pressures, reduced economic activity, political uncertainty and external imbalances. Nevertheless, the sector posted a significant growth of 34.5 percent in CY23 (26.7 percent in CY22) driven almost solely by the Asset Management[2] segment, which dominates the NBFIs sector with 89.6 percent asset share (**Table 6.2.1**)

Asset Profile of NBFIs — Table 6.2.1

billion Rupees

		Dec-21	Dec-22	Dec-23
Asset Management	**AMCs/IAs (own assets)**	**46**	**48**	**58**
	Mutual Funds	1,192	1,574	2,232
	Pension Funds	40	44	61
	Portfolios	374	358	547
	Total AUMs	**1,605**	**1,976**	**2,840**
	RMCs	8	9	13
	REITS	67	168	168
	PE & VC Firms	0	0	0
	PE Funds	10	12	10
Lending	Modarabas	57	65	56
	Leasing Companies	5	6	6
	Housing Finance Cos.	0	1	1
	IFCs	78	109	100
	NBMFCs	146	168	195
	Total Assets	**2,023**	**2,563**	**3,447**

Source: Securities and Exchange Commission of Pakistan

6.2.1 Asset Management Segment (AM)

The AM segment increased its asset base to Rs 3,089 billion, posting an impressive growth of 39.6 percent in CY23 as compared with 27.5 percent in CY22. This segment is dominated by Mutual Funds and Portfolios. The Assets Under Management (AUM)[3] registered a substantial growth of 43.7 percent in CY23 driven by strong growth in both the Mutual Funds and Portfolios.

Strong growth in mutual funds further extended their asset share in the NBFI sector…

The mutual funds, with a share of 64.7 percent in the NBFIs' overall asset base, recorded a notable growth of 41.8 percent over the year, mainly driven by Islamic income and money

[1] NBFIs for the purpose of this analysis include NBFCs, Real Estate Investment Trusts (REITs), and Modaraba Companies. As per section 282A of the repealed Companies Ordinance, 1984 (wherein Part VIIIA - consisting of sections 282A to 282N – does not stand repealed and is applicable to NBFCs), Nonbanking finance companies (NBFCs) include companies licensed by the Commission to carry out any or more of the following forms of business, namely: Investment finance services, Leasing, Housing Finance Services, Venture Capital Investment, Discounting Services, Investment Advisory Services, Asset Management Services, and any other form of business which the Federal Government may, by notification in the official Gazette specify from time to time. Non-bank Microfinance Companies (NBMFCs) are also included in NBFCs.

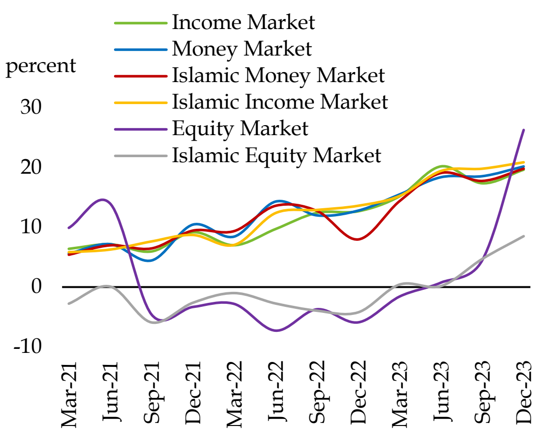
[2] The Asset Management (AM) segment includes: Asset Management Companies (AMCs), Investment Advisors (IAs), Real Estate Investment Trusts (REITs), Mutual Funds, Pension Funds, Private Equity (PE) Funds, and Discretionary/ Non-discretionary Portfolios.

[3] Assets Under Management (AUM) include assets of mutual funds, pension funds, and portfolios under management of AMCs/ IAs.

market funds. The major thrust in growth came in the latter half of the year when economic and political uncertainties subsided, and SBP kept the policy rate unchanged in H2CY23 after a cumulative 600 bps increase in H1CY23.

Investors continued to prefer the debt instruments as an investment option during CY23, as they offered lower level of risk and yielded better returns compared to equity funds. (**Figure 6.2.1**). The growth in AUM was primarily due to the increase in net sales in CY23 followed by higher returns (**Figure 6.2.2a**).

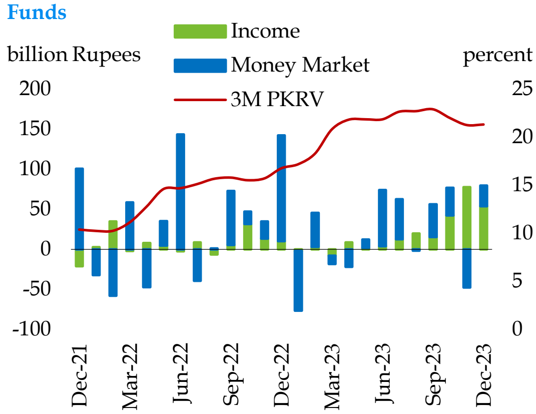
Monthly Returns of Mutual Funds **Figure 6.2.1**



Source: Mutual Funds Association of Pakistan

Equity funds, after contracting in CY22 and H1CY23, also rebounded to increase its asset base in the latter half of CY23, as the KSE-100 index saw sharp gains in the wake of improvement in economic outlook and developments, e.g., securing of IMF-SBA program, clarity on general election schedule,

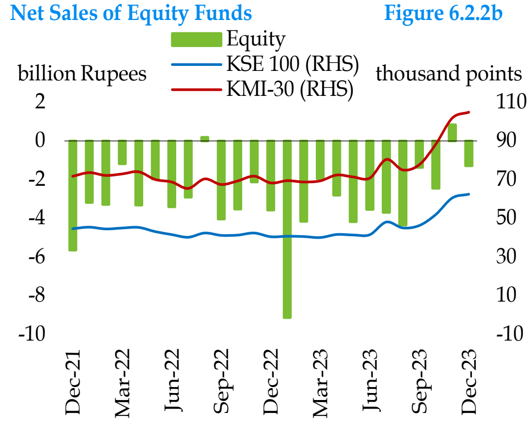
Net Sales of Money and Income Funds **Figure 6.2.2a**



Source: Mutual Funds Association of Pakistan

reduced political uncertainty, and better corporate profitability. Overall equity funds posted a growth of 9.1 percent in CY23, reaching Rs 202.8 billion in CY23 from Rs 169.4 billion in CY22. This growth was mainly attributed to increase in Net Asset Value (NAV). As far as net sales are concerned, the equity market continued to face redemptions in CY23 (**Figure 6.2.2b**).

Net Sales of Equity Funds **Figure 6.2.2b**



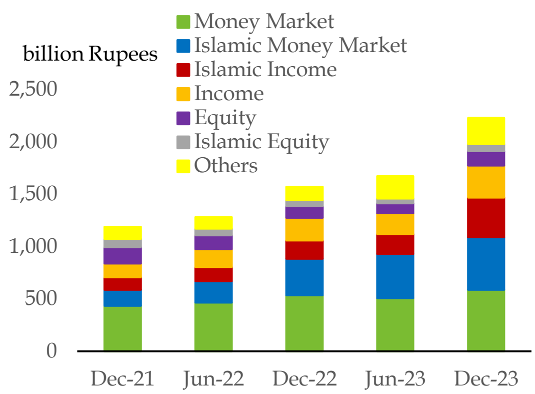
Source: Mutual Funds Association of Pakistan & Pakistan Stock Exchange

The number of Asset Management Companies/ Investment Advisors remained 29 in CY23, unchanged from the previous year. However, their own asset base increased from Rs 48 billion in CY22 to Rs 58 billion in CY23, showing a strong growth of 20.7 percent. The number of funds and plans managed by AMCs/IAs also increased from 313 to 345 while the total AUM increased from Rs 1,574 billion in CY22 to Rs 2,232 billion in CY23.

Money market funds continued to dominate while income fund also made asset share gains…

The composition of mutual funds is still dominated by money market funds despite a decline in its asset share from 56.2 percent in CY22 to 48.8 percent by the end CY23. Following a notable growth, particularly in the latter half of CY23, asset share of income market funds in mutual funds increased from 24.8 percent in CY22 to 30.8 percent in CY23 (**Figure 6.2.3**).

Composition of Mutual Funds Figure 6.2.3



Source: Securities and Exchange Commission of Pakistan

However, money and income funds, at Rs 1,777 billion, constitute about 79.6 percent of mutual funds in CY23. The higher interest rate environment has led to increased competition in the debt market as there are limited investment avenues available. This could potentially lead to concentration risks. Particularly, money market is encountering challenges in identifying ample short-term investment opportunities, given the limited availability of short-term instruments with maturities of six months or less in the secondary market.

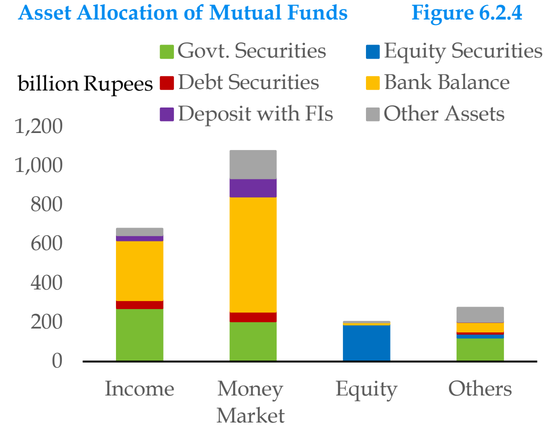
Further, there was also a remarkable growth in Islamic income and money market funds as their asset base grew to almost catch up with their conventional counterparts. Islamic money market and income funds grew at 68.4 percent to reach Rs 882 billion in CY23 while conventional money market and income funds grew at 19.1 percent to reach Rs 895 billion. Besides the consideration of Shariah-compliant investment, higher returns on Islamic funds vis-à-vis saving accounts of Islamic banks which generally offer relatively low returns to depositors, may have attracted more investors to these funds.

As such, policy makers are deliberating on the potential issuance of short-term Islamic debt instruments to enhance and diversify investment opportunities, particularly in the Islamic money market.[4]

Overall mutual funds maintained a low risk profile…

The asset allocation of mutual funds indicates that bank balances, government securities, and deposits with financial institutions (FIs) form a high share in the money and income funds. Given the contained credit risk, ready liquidity of these investments, and steady performance and resilience of the domestic banking sector, mutual funds face limited risks on these investments and fund placements (**Figure 6.2.4**).

Asset Allocation of Mutual Funds Figure 6.2.4



Source: Securities and Exchange Commission of Pakistan

In terms of quality of portfolio and asset quality, total classified assets of the mutual funds industry also declined from Rs 3.5 billion to Rs 2.3 billion in CY23, constituting only 0.1 percent of assets under management.

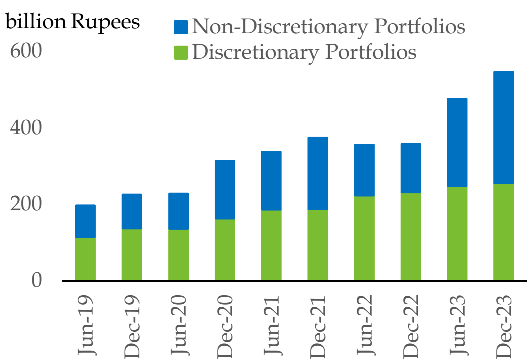
Portfolios also registered impressive growth driven by non-discretionary portfolios...

[4] Annual Report 2023, Securities and Exchange Commission of Pakistan (SECP)

Portfolios (Under Management)[5] have the second highest market share in the NBFIs at 15.9 percent, following the mutual funds.

Portfolios recorded a notable growth of 52.9 percent to reach Rs 547 billion in CY23 (Rs 358 billion in CY22), following a slight contraction in CY22. The growth was concentrated in the non-discretionary portfolios, as its assets grew from Rs 126 billion in CY22 to Rs 291 billion in CY23, leading to an increase in its asset share in total portfolios to 53.1 percent in CY23 (35.3 percent in CY22) (**Figure 6.2.5**).

Classification of Portfolios by Investment Decision Making **Figure 6.2.5**



Source: Securities and Exchange Commission of Pakistan

REIT sector was marked by a slowdown in CY23 owing to reduced economic activity and policy uncertainty…

REIT[6] sector has emerged as a relatively new investment avenue for small investors over the recent years, enabling them to invest in real estate projects. Although, eight more REIT Management Companies (RMCs) were licensed in CY23, taking the total number of RMCs to 24, only 4 of these RMCs were offering REIT schemes to investors as of end CY23.

Widespread outreach efforts by the regulator coupled with amendments to REIT regulations led to an increase in the number of schemes from 11 to 15 in CY23. However, the asset base of the REIT sector increased only marginally from Rs 167.6 billion in CY22 to Rs 168.4 billion in CY23, primarily because of the slowdown in real estate sector during CY23 amidst the reduced economic activity, low business sentiments and uncertain political situation in the country.

Pension funds registered strong growth in CY23, though their share in overall NBFI sector remained low…

Pension funds also registered a strong growth of 39.3 percent in CY23, increasing the asset base from Rs 44 billion to Rs 61 billion. Both the conventional and Shariah compliant pension funds contributed to the growth.

Khyber Pakhtunkhwa government launched a voluntary pension scheme (VPS) in CY23 for its employees that have joined the government service on or after June 07, 2022. In this scheme, employees' and employers' contributions are both invested and the proceeds are used to buy a pension and/or other benefits at retirement. This step has the potential to solve the problem of growing public pension bill, and efficiently managing the fiscal space.

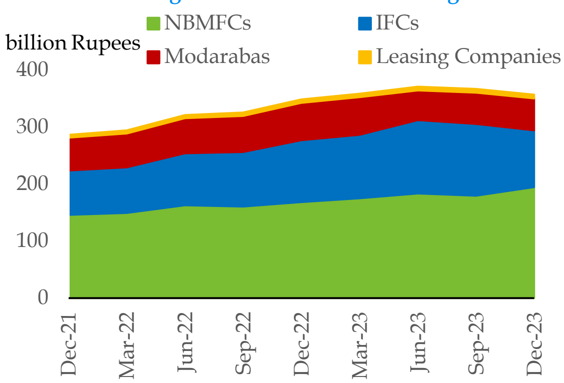
[5] Portfolios (Under Management) are investments of eligible investors (person offering a minimum of Rs 3 million investment) managed by investment advisors. Under "Discretionary Portfolios", investment decisions are made and executed by the investment advisor on behalf of clients. While under a "Non-Discretionary Portfolio", investment decisions are executed as per the written instructions of the clients.

[6] Real Estate Investment Trusts (REITs) are investment schemes that own and most often actively manage income-producing real estate. Through such schemes, investors may own, operate or finance income generating property across various categories of real estate. For further details, please see: https://invest.gov.pk/sites/default/files/2020-08/REITS%20FAQs.pdf

6.2.2 Lending NBFIs Segment

The higher interest rates and economic downturn presented the lending segment of NBFIs with substantial challenges.[7] Lending segment holds 10.4 percent of the market share in the NBFI sector. This asset base of the segment expanded modestly by 2.4 percent in CY23 to reach Rs 357.8 billion as compared to 21.6 percent growth in the previous year. The marginal growth in CY23 reflects the impact of elevated policy rate during the year amidst inflationary pressures and reduced economic activity. Non-bank Microfinance Companies (NBMFCs) exhibited growth in the lending segment while investment finance companies (IFCs) and Modarabas experienced contraction during the year under review (**Figure 6.2.6**).

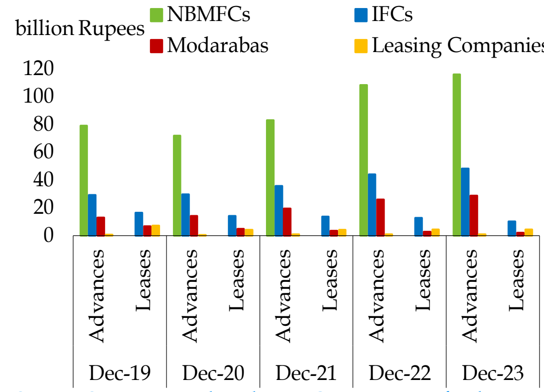
Assets of Lending NBFIs **Figure 6.2.6**



Source: Securities and Exchange Commission of Pakistan

NBMFCs continued to dominate the advances portfolio of lending NBFIs. The expansion in the advances portfolio of the NBFIs' lending segment decelerated in CY23 to 8.3 percent (28.7 percent in CY22) due to stressed macroeconomic conditions which also reflected in negative growth in banking sector's advances to private sector (**Figure 6.2.7**).

Advances and Leases of Lending NBFIs **Figure 6.2.7**



Source: Securities and Exchange Commission of Pakistan

NBMFCs registered growth expanding its asset share in the lending segment …

The NBMFCs expanded its asset share within the lending segment to 54.4 percent (48.2 percent in CY22) after posting a growth of 15.6 percent in CY23 despite a challenging macroeconomic and financial environment.

The high interest rate environment coupled with elevated inflation and dampened economic activities, that particularly affect the repayment capacity of low-income segment of the society, curtailed the expansion in the advances portfolio of NBMFCs, which grew at a modest rate of 7.0 percent during CY23 as compared to 30.3 percent in CY22. The share of advances in total assets of NBMFCs also fell down from 64.6 percent in CY22 to 59.9 percent in CY23, as the NBMFCs shifted their strategy towards investments and bank placements seeking to capitalize on higher returns at relatively low risks.

Even though NBMFCs have shown resilience and registered growth in CY23, the tightened macro financial conditions for longer periods can pose challenges for NBMFCs as their borrowers significantly lack cushions to withstand severe and prolonged economic shocks while the operating cost of these

[7] Lending NBFIs (also referred to as the non-AM segment) include Leasing Companies, Modarabas, Investment Finance Companies, Housing Finance Companies, Non-Bank Microfinance Companies (NBMFCs), etc.

institutions are high due to the peculiar nature of business.

Classified assets of Investment Finance Companies (IFC) sector saw a sharp increase as new entries helped advances portfolio grow…

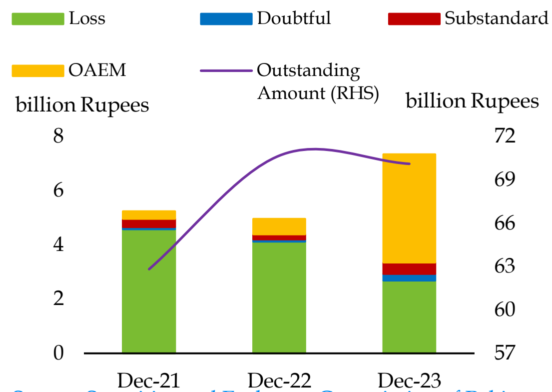
Although, a few new players entered the IFC sector, the asset base of IFCs contracted by 8.4 percent from Rs 109 billion in CY22 to Rs 100 billion in CY23. The decline in investments and money deposits, contributed towards contraction in asset base, while the advances portfolio posted a decent growth of 9.5 percent in CY23.

The IFC sector continued to be dominated by a couple of institutions, constituting about 68.9 percent of the asset share in the sector. These two major firms were also the drivers of increase in advances. Additionally, there were also new entries, of predominantly fintechs, into the market which further boosted the advances portfolio. One of the two large firms mostly operates as an institutional lender providing financing to NBMFCs while the other has recently diversified its portfolio by moving from leasing to advances.

The asset contraction of the sector was also mainly driven by one of the two large firms as it disposed of about 80.7 percent of its investments to pay off some of its liabilities as well as increase its lending portfolio over the year.

The classified assets of the IFC sector have shown a sharp increase reaching Rs 7.3 billion in CY23 from Rs 4.9 billion, particularly driven by increase in OAEM category. However, this increase does not seem to be broad based and could be an attendant consequence of shifting from leasing to advances portfolio. Although, this is not an immediate concern, the prevailing strain in macro financial conditions warrants enhanced focus and risk management efforts to ensure effective management of stressed loan portfolio and stem further delinquencies. Further, the entry of fintechs into the market necessitates timely enhancement of the regulatory and supervisory frameworks to further improve their efficiency to mitigate any emerging risk (**Figure 6.2.8**).

Classified Assets of IFC Sector **Figure 6.2.8**



Source: Securities and Exchange Commission of Pakistan

Modarabas saw growth in advances despite the stressed macro financial environment…

The asset base of the Modarabas[8] segment declined from Rs 65 billion in CY22 to Rs 56 billion in CY23. However, this was mainly attributed to the conversion of a few Modarabas to normal listed companies as well as separation of one division of a Modaraba, effectively decreasing the total number of Modarabas from 27 in CY22 to 22 in CY23.

The advances portfolio of Modarabas experienced a decent growth of 11.0 percent in CY23, increasing from Rs 25.8 billion to Rs 28.6 billion despite the high interest rate environment. The deposits also posted a modest growth rate of 5.5 percent in CY23. The deposit to assets ratio of the sector increased from 28.0 percent in CY22 to 34.8 percent in CY23, getting closer to the equity to assets ratio of 41.6 percent.

The infection ratio of the sector also continued its declining trend from last year, further

[8] The Modarabas are Islamic financial institutions, which are allowed to conduct any business, provided it is Shariah-compliant and approved by the Religious Board of Modarabas. For example, Modarabas can undertake Ijarah (leasing), Murabaha (cost plus sale), Musharakah (partnership), Diminishing Musharakah, Salam (deferred delivery sale) and Istisna financing activities; invest in the stock market; trade halal commodities; conduct project financing activities; manufacture items; among other activities.

decreasing to 6.8 percent in CY23 (9.3 percent in CY22 and 11.7 percent in CY21) indicating better asset quality management.

Generally, the Modaraba sector has proved resilient and posted a slight growth in assets in the latter half of the year. However, the sector faces numerous challenges in a challenging business environment marked by high inflation and external account pressures, tightened economic policies, and slowdown in economic activities and low investors' sentiments.

Leasing sector saw muted activity in CY23…

The leasing sector has remained more or less stagnant with an asset base of about Rs 6 billion over the past few years. A new entry into the market kept its asset base from shrinking further over the year.

Interconnectedness between banking and Mutual Funds sector remained manageable in CY23…

The banking sector's stake in the mutual funds industry increased over the year as banks injected more equity into their associated AMCs/IA. However, at Rs 13 billion, the investments of banking sector in mutual funds is miniscule given the size of banks' asset base.[9] Considering their relative sizes as well as the risk profile of the mutual fund industry, any accumulation and transfer of systemic risk from asset management segment to banking sector remained minimal during the year under review.

However, banks owned AMCs/IAs managed around 79.1 percent of the total assets under management which highlights the implications of performance of the sector for the concerned banks' reputation, though the banks' direct investments in mutual funds remain low. Conversely, mutual funds also increased their investments in banking products such as deposits and securities to reap rewards of high returns at relatively low levels of risk. This underscores the crucial role of banking sector's performance and stability for the mutual funds industry (**Table 6.2.2**). Nevertheless, any concerns of systemic risks in inter sector

Asset Management Segment's Flow of Funds and Exposure to the Banking Sector — Table 6.2.2

Description	Dec-21			Dec-22			Dec-23		
	Total Value (i)	Banks share (ii)	Banks share in Total* (iii= ii/i)	Total Value (iv)	Banks share (v)	Banks share in Total* (vi= v/iv)	Total Value (vii)	Banks share (viii)	Banks share in Total* (ix= viii/vii)
	billion Rupees		percent	billion Rupees		percent	billion Rupees		percent
1. Equity of AMCs/ IAs	33	17	53.0	33	18	55.4	43	25	58.7
2. Assets Under Management of AMCs/ IAs	1,605	1,257	78.3	1,976	1,537	77.8	2,840	2,247	79.1
3. Mutual Funds size	1,192	22	1.8	1,574	15	0.9	2,232	13	0.6
4. Mutual Fund exposure in Financial Institutions	724	673	92.9	749	589	78.6	1,111.16	972	87.4
5. Mutual Funds exposure in top 20 equity securities	75	9	12.5	62	5	8.4	56	7	11.7
6. Mutual Funds exposure in top 10 debt securities	20	7	36.7	64	9	14.7	64	9	13.9
7. Top 20 holders of mutual fund units	194	14	7.1	344	27	7.9	393	-	-

*Banks share for the respective head means:
1.Equity of Bank-owned AMCs /IAs
2.Mutual/Pension Funds and Portfolios being managed by bank-owned AMCs /IAs
3.Banks' investments in mutual fund units
4.Mutual Funds' investments in deposits, COD/TDR/COI and money at call/placements with banks
5.Mutual Fund investments in ordinary shares of banks
6.Mutual Funds investments in TFCs/Commercial Paper/Sukuk etc. issued by banks
7.Banks(investment value) in the top 20 holders of mutual fund units

Source: Securities and Exchange Commission of Pakistan

[9] The asset and equity base of banking sector are Rs 46.3 trillion and Rs 2.5 trillion respectively while the total size of AUM is Rs 2.8 trillion at end CY23.

exposures between banking sector and NBFI sector remained manageable given the relatively smaller size of these exposures, and stability and resilience of the banking sector.

Going forward, the performance of the NBFI sector will depend upon the economic recovery, traction of stabilization measures and IMF program, political stability, and any effects of ongoing geo-political conflicts on international commodity markets. These factors will have a discernible impact on macro financial environment through interest rates, exchange rates and economic activity that will trickle into preferences of investors as well as the strategy and growth of NBFI sector.