

**SIXTEENTH SUPPLEMENTAL  
TO THE  
OFFERING DOCUMENT  
OF**

**MCB PAKISTAN ASSET ALLOCATION FUND (MCB-PAAF)**

**MANAGED BY  
MCB ARIF HABIB SAVINGS AND INVESTMENTS LIMITED**

**Dated: 14 December, 2022**

This Sixteenth Supplemental Offering Document dated 14 December, 2022 to the Offering Document of MCB Pakistan Asset Allocation Fund (MCB-PAAF) was approved on March 07, 2008.

**Managed by MCB Arif Habib Savings and Investments Limited, an Asset Management Company managing Collective Investment Schemes, registered with the Securities and Exchange Commission of Pakistan (SECP) and regulated under the Non-Banking Finance Companies (Establishment and Regulations) Rules, 2003 and the Non-Banking Finance Companies and Notified Entities Regulations, 2008.**

MCB Pakistan Asset Allocation Fund (the Fund/the Scheme/the Trust/the Unit Trust/MCB PAAF) has been established in Pakistan as an Open-ended unit trust scheme under the Non-Banking Finance Companies and Notified Entities Regulations, 2008 (the “Regulations”) and registered under the Trust Act 1882 (11 of 1882) by a Trust Deed dated November 22, 2007, entered into and between MCB Asset Management Company Limited, as the Management Company and the Central Depository Company of Pakistan Limited, as the Trustee. MCB Asset Management Company Limited has been amalgamated with and into Arif Habib Investments Limited with effect from June 27, 2011. After this date, MCB Arif Habib Savings and Investments Limited is acting as the Management Company of MCB PAAF. Further, under a newly introduced Sindh Act, 2020; the Trust Deed(s), registered under Trust Act 1882 are now also being registered under Sindh Act 2020.

Sub clause 2.1.1.2 (19) to the Offering Document and row 12 with regard to “Investment in Equity Future Contracts” of the Authorized Investment table have been amended and Sub clause 2.1.1.2 (24) & 2.3(p) and row in the last in the Authorized Investment Table under sub clause 2.1.1.2 has been added and to read in their entirety as follows:

# **1. Amendment of Sub-clause 2.1.1.2 (19) to the Offering Document**

*Amended text to be read as:*

## **(19) Investment in Equity Futures Contracts**

### **A. Introduction of Equity Futures Contracts**

Futures are a type of derivative financial contracts that obligate parties to transact an asset at a predetermined future date and price. For equities futures, it becomes a contract to buy or sell shares in a regulated market at a predetermined price at a specified time in future, regardless of current market price.

Types and period of maturity of Futures Contracts which are eligible for investment by Scheme are as follows:

#### **I. Deliverable Futures Contract (DFC)**

DFC require to buy or sell shares with actual delivery of said shares at the maturity of the contract. These contracts have a period of one (1) month with last Friday of calendar month as the maturity date for the contract, with settlement of T+2 immediately after close of the contract.

#### **II. Single Stock Cash Settled Futures Contract (CSFC)**

CSFC are standardized contracts to buy/sell single stock futures to be settled in cash, where the result of the trade is the cash difference between the buying and

selling price without any delivery of shares. Period of contract ranges from seven (7), thirty (30) or ninety (90) days with last Friday of the calendar month/week as maturity date having settlement at T+1.

### **III. Stock Index Futures Contract (SIFC)**

SIFC is an agreement to buy or sell a standardized value of a stock index (basket of shares) on a future date at a specified price. SIFC gives opportunity to investors to trade in entire stock market by buying index futures instead of buying individual securities. Contract period is of ninety (90) days with last Friday of the calendar month as the maturity day.

## **B. Treatment of Equity Futures Contracts**

Futures Contracts provide a hedging window whereby quantity and price of shares can be locked for a future settlement date. In addition, it improves the liquidity dynamic for the Scheme by providing an additional futures window. The Scheme can also benefit from low margin requirement on the futures to attain marginal returns, helping the Scheme in achieving its objective of increasing Unit Holders' returns.

## **C. Extent and manner of participation of the Scheme in Equity Future Contracts**

- (a) The Scheme may invest in Deliverable Equity Futures Contracts or Cash Settled Equity Futures Contracts subject to the condition that difference between the contract price and upfront margin shall be invested in cash and near cash instruments i.e. Treasury Bills of less than ninety (90) days maturity and Government of Pakistan (GoP) Ijarah Sukuks not exceeding 90 days remaining maturity and cash in bank account (excluding TDRs or other term deposits).
- (b) The Scheme may sell Deliverable Equity Futures Contracts against its existing ready market open purchase position in the same scrip if such open position will settle prior to or on the same settlement date as the settlement of Deliverable Equity Futures Contracts or against shares held in CDC.
- (c) The Scheme may sell Deliverable Equity Futures Contracts against its existing deliverable futures purchase position in the same security till such time that such position is settled. The Scheme may sell Cash Settled Equity Futures Contract against its existing cash settled equity future purchase position in the same security till such time that such position is settled. This exposure however, shall not exceed 40% of its net assets.
- (d) The Scheme may sell in Cash Settled Futures Contracts maximum upto five percent (5%) of the total Net Assets of the Scheme without pre-existing interest in the security provided that it complies with the relevant regulations of Pakistan Stock Exchange. This position, however, shall be covered by underlying cash or near cash instruments.
- (e) The Scheme shall not blank sale in Deliverable Equity Future Contracts.

- (f) Exposure (net long or net short) in Equity Futures Contracts shall not, at any time, exceeds total Net Assets of the Scheme.
- (g) Exposure in Equity Future Contracts shall be marked to market on a daily basis as per requirement of the Pakistan Stock Exchange.

#### **D. Purpose of Equity Future Contracts**

The Scheme will use Equity Futures Contracts to achieve both hedging (Ready/Futures Spread) and capital growth (Futures Buy/Sell).

#### **E. Description of Risk Management and Compliance Procedures**

Leverage, interest rate, liquidity, settlement and operational risks are inherent risk of futures trading. However due consideration of leverage positions and liquidity position in the market will be used to mitigated these risks by limiting allocations to the scripts accordingly. Interest rate outlook formed by analyzing economic factors will guide in overall allocation of funds in futures contracts. Futures transactions would be handled by trained and experienced staff which will substantially mitigate settlement and other operational risks

#### **F. Compliance Measures**

In addition to compliance monitoring mentioned in Paragraph (c) and (d) above, compliance of exposure limits prescribed under Regulation No. 55 of the NBFC Regulations shall also be observed.

#### **G. Risk Management Measures**

The Management Company shall ensure that necessary risk management measures are in place to enable the Management Company to monitor, measure and manage the risks of the Scheme's position in Equity Futures Contracts and their contribution to the overall risk profile of the Scheme.

Following are the risks associated with trading futures contracts in a CIS:

##### **1. Liquidity Risk**

Liquidity risk is an important factor in trading. If a trade is executed, there is always a risk that it can become difficult or costly to exit from positions in illiquid contracts. For e.g. if fund buys Deliverable Futures Contract on a share which has low liquidity and some negative development occurs in the company then fund manager might decide to reverse his position by selling Futures Contracts but he may not be able to take counter position as there will be no buyer and fund might have to take maximum loss as position will be settled at month end. Liquidity risk will be reduced by taking positions in stocks that are substantially liquid with reference to the size of the trade. Fund Manager with the help of average traded value and market conditions will set criteria and size of trade.

**Control for Deliverable Future Contract:** Minimum value traded in the last 20 trading sessions will be determined in the futures contracts of the share in which trade has to be done. Fund manager will not take more than 25% of that minimum traded value. Position cannot be increased in subsequent days before the settlement/closure of the trade.

**Example:** If fund manager decides to buy shares in future contract on first day of the opening of futures contract, he will find out minimum value traded in last 20 sessions in futures contracts of shares. If this minimum value comes out to be Rs 40m then he will not make a trade of above Rs 10m in that contract (which may be completed in several days). Now if he completely reverses his position on 10th day of contract he may take fresh position by determining minimum value again. However if he decides to carry over his position until final settlement he would not be able to increase his position above Rs 10m limit.

## 2. Operational Risk

Operational risk summarizes the uncertainties and hazards a company faces when it attempts to do its day-to-day business activities within a given field or industry. A type of business risk, it can result from breakdowns in internal procedures, people and systems—as opposed to problems incurred from external forces, such as political or economic events, or inherent to the entire market or market segment, known as systematic risk.

Errors due to manual mistakes by staff are a major area of risk. Measures like adequate staff training, supervision, internal controls, and documentation of standard operating procedures and segregation of tasks are essential for running smooth, error free operations which as a result lead to reduction in instances and impact of operational risks. However, for Fund's point of view, such risk is covered through applicable NBFC Regulation and Constitutive Documents and shall be borne by AMC, if happened.

## 3. Leverage

One of the chief risks associated with futures trading comes from the inherent feature of leverage. Lack of respect for leverage and the risks associated with it is often the most common cause for losses in futures trading. Exchange sets margins at levels which are deemed appropriate for managing risks at clearinghouse level. This is the minimum level of margins required by the exchange and provides maximum leverage. For example, if the initial margin for gold is 2.5%, it implied 40 times leverage. In other words, a trader can take a position equivalent to Rs. 100,000 by only depositing Rs. 2,500 in his or her account. Clearly, this represents great amount of leverage which is defined as the ability to take large exposures with little upfront cost. This tempts greedy investors to take big

positions which are beyond their capacity to finance in case market value of the contract declines sharply. This increases chances of his default.

#### 4. Interest Rate Risk

The risk that an investment's value will change due to a change in the absolute level of interest rates. Normally, rise in interest rates during the investment period may result in reduced prices of the held securities. Investors usually submit margins in the form of debt securities. If interest rate rises sharply value of these securities also declines. So to cover up this reduction in margin more securities or cash is demanded from the investor for which he may not be prepared and this increases risk of default.

#### 5. Settlement and Delivery Risk

All executed trades need to be settled and closed at some point. Daily settlement takes the form of automatic debits and credits between accounts with any shortfalls being recovered through margin calls. Brokers are obligated to fulfill all margin calls. Use of electronic systems with online banking has reduced the risks of failed daily settlements. However, non-payment of margin calls by clients poses a serious risk for brokers.

### 2. Addition of Sub-clause 2.1.1.2 (24) to the Offering Document

*Added text to be read as:*

2.1.1.2 (24) The Management Company on behalf of the Scheme may take exposure in units of all types of Exchange Traded Funds maximum upto 10% of the Net Assets of the Scheme.

### 3. Amendment of row 12 and addition of last row in Authorized Investment Table with regard to Investment in Equity Future Contracts and Units of Exchange Traded Fund to the Offering Document

*Amended text to be read as:*

Asset Classes	Minimum Entity Rating	Minimum Instrument Rating	Maximum Exposure Limit (% of total net assets)

<i>Investment in equity future contracts.</i>  <i>(Other than future contract specified below)</i>	N/A	N/A	40%
<i>Investment in Cash Settled Future Contracts without pre-existing interest in the security provided</i>  <i>(Cash Settled Future Contracts – Uncovered up to 5% of the Net Assets.)</i>	N/A	N/A	5%
<i>Units of Exchange Traded Funds</i>	N/A	N/A	10%

#### **4. Addition of Sub-clause 2.3 (p) to the Offering Document**

*Added text to be read as:*

(p) The Management Company shall not charge management fee on such percentage of Net Assets of the Scheme which are invested in the Units of ETFs managed by the same Management Company.