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A long-exposure photograph of a multi-lane highway at sunset. The sky is filled with dark, dramatic clouds, with a bright orange and yellow glow from the setting sun on the horizon. The highway lanes are filled with light trails from moving vehicles, with red trails on the left side and white/yellow trails on the right side, creating a sense of motion and speed.

Keeping up
with change
**in fast-moving
emerging markets**

For international asset managers, emerging markets present rare growth opportunities. Rapidly growing economies, an expanding savings base and increasing liberalization – all these factors make the major markets of Asia, the Middle East and Latin America prime destinations for leading brand names. That said, little is simple in international fund marketing. These markets are moving targets.

While most are opening up to foreign firms, the pace of change is far from even and subtle shifts in regulation can have a significant impact on the products firms sell and the channels through which they can distribute them. Keeping abreast of these changes is vital if asset managers are not to be left behind.

In this article, we take a look at developments in some of the most exciting markets – China/Hong Kong, India, the Middle East and Brazil – and assess what they mean for asset managers keen to tap inward and outward flows in these territories and position themselves for the growth each market promises for the future.

China and Hong Kong: Internationalization of RMB Throws Up New Opportunities

With the signing of a memorandum of understanding between the Hong Kong Monetary Authority and the People's Bank of China in July 2010, the long-awaited opening up of an offshore market in Hong Kong in renminbi-denominated (RMB) securities and funds is at last becoming a reality. "Chinese currency funds are the hot topic right now," says Cheeping Yap, Hong Kong Head of Securities and Fund Services for Citi's Global Transaction Services: "Until the memorandum of understanding (MoU), firms were only allowed to open RMB accounts for trade-related purposes. Now financial institutions can develop RMB products."

Mr. Yap says there is a major mismatch at present between the scale of RMB deposits in Hong Kong and the size of the RMB-denominated corporate bond

market. "There is a total of around US\$12 billion of RMB deposits in Hong Kong earning around 0.2% but only US\$3.5 billion of RMB corporate bonds. More issues are scheduled for the second half of the year." In an encouraging sign, McDonald's recently raised a \$29 million RMB-denominated bond while the Hong Kong-based toll road operator, Hopewell Highway Infrastructure, announced plans to raise \$150 million in RMB-denominated bonds. Previous issues had all been by mainland banks, onshore subsidiaries of foreign banks or the Chinese government.

The next step is expected to be the launch of RMB-denominated equity funds. "We expect regulation shortly to allow Chinese securities firms and fund managers to offer offshore RMB equity funds in Hong Kong," says Mr. Yap. Moreover, permission for the Qualified Chinese Institutional Investor (QCII) funds could come anytime in the next six months.

Alvin Goh, Director, China Securities Country Manager for Citi's Global Transaction Services, says the moves are part of a wider strategy on the part of the Chinese authorities to establish the RMB as an international currency within the Asia region. "Hong Kong is likely to be the offshore center, but the People's Bank of China has signed swap agreements with six other countries, too.

"We also expect non-Chinese corporations to be allowed to come to China to issue RMB debt which will be traded in the Chinese interbank market. This market is outside the scope of the existing Qualified Foreign Institutional Investor (QFII) program – through which foreign investors are allowed to invest in mainland stocks – and only selected investors are likely to be allowed in," he says.

There has been a slowdown in new QFII approvals of late, which Mr. Goh puts down to two likely causes: "It is to allow both QFII regulators to sync their approval process and balance the capital flows given China's current situation." Only three new QFII investors were approved in the first half of 2010, compared with ten in the same period last year. Total new QFII approvals increased the quota by US\$1.15 billion to over US\$17 billion in total. When the QFII scheme was set up in 2003, it was with a US\$30 billion ceiling.

The development of the Chinese markets continues apace. In April 2010, the China Financial Futures Exchange started trading futures on the China Securities Index 300. QFII investors have in principle been given approval to trade the futures but the detailed regulation is still awaited. The point to note, says Mr. Goh, is that QFII fund managers launching in Asia can now include the opportunity to trade Chinese equity futures in their prospectus.

The opening up of the RMB market and Hong Kong's increasing role as China's favored offshore center both add a new dimension to the China growth story. Hong Kong is also seeing a boom in private wealth management, says Mr. Yap, as a wave of Chinese IPOs throws off a new generation of mega-wealthy individuals. Taken together with the progressive broadening of the QFII program, recent developments have only served to underline China's position as the number one target destination for international asset managers.

India: Best Is Yet to Come

With foreign inflows of more than US\$10 billion over the year to date, 2010 is shaping up to be the best year since 2007 for net inflows into India's securities markets. "The money is not just coming from Asian funds," says Sundaresan Naganath, President and Chief Investment Officer of India's DSP BlackRock Investment Managers. "It is largely allocations from global portfolios. That reflects the anticipated high growth rates in the Indian economy

over the next three to five years and even higher rates of corporate earnings growth," he says.

At present, some 38 asset managers compete in the Indian market. "Another half dozen are either in the process of setting up or applying to enter the market," says Mr. Naganath. DSP BlackRock, which was set up 13 years ago, currently manages around US\$4.7 billion of locally sourced funds in addition to advising US\$1.7 billion of international money invested in India.

The newcomers may find distribution more of a challenge than in the past. In 2009, the Securities & Exchange Board of India (SEBI) banned the practice of front-end loading – the payment by investors of entry fees charged to mutual funds. Now distributors, including independent financial advisors (IFAs) must either charge their retail clients a fee for their advice or negotiate separate payments from asset managers.

"Long-term, the move is a good one – introducing more transparency for retail investors and buying them more units for the same investment," says Debopama Sen, Director, India Securities Country Manager, Global Transaction Services, Citi. "And India has often led the way for paradigm changing regulation. But the feedback from asset managers is that the industry needs more time to adjust to the change," she says. There are newspaper reports suggesting many IFAs have decided either to switch to selling unit-linked insurance products or private equity products, where there are attractive commissions, or have closed down. Clearly, only the serious players who are able to add value to the investor may be able to survive.

Therefore, after an initial hiccup, mutual fund sales are picking up again. "The market has rebounded in an intelligent manner," says Mr. Naganath: "In May 2010 we launched the DSP BlackRock Focus 25 Fund and raised approximately US\$143 million. We expect the market to continue to improve over the next 12 months."



The key now is to find distribution channels not only in the big cities but in the smaller ones, too. "Sophisticated bank distribution is concentrated in the main cities," says Ms. Sen: "Asset managers need to cast their net more widely." Mr. Naganath agrees: "DSP BlackRock has over 20,000 distributors, made up of banks, national distributors and IFAs. The industry has historically derived around 80% of its assets from the top ten cities. Now the biggest growth rates are in the smaller cities and towns."

The key now is to find cost-effective distribution channels in the smaller towns. "Major distribution networks are concentrated in the main cities," says Ms. Sen: "Asset managers need to cast their net more widely." Mr. Naganath agrees: "DSP BlackRock has over 20,000 distributors, made up of banks, national distributors and IFAs. The industry has historically derived around 80% of its assets from the top ten cities. Now the biggest growth rates are in the smaller cities and towns."

In one interesting development, says Ms. Sen, investors can now use the stock exchange platform to subscribe to or redeem mutual fund units – charging negotiated brokerage fees. "The change was only introduced a few months back and these are early days yet," she says: "But maybe there is an opportunity here for asset managers to effectively penetrate the market, given the far reaching network of the exchanges."

India is a market where asset managers must invest for the long term. Given the capital requirements to set up, many international managers have set up joint ventures with local firms. "Six Asset Management Companies (AMCs) entered the market in the last two years with their mutual fund offering and Citi supports the infrastructure needs for four of these firms," says Ms. Sen. Most of the international managers either market domestic funds or local feeders into their overseas funds. "There is no sign of a change in regulation in the immediate future to permit offshore funds to sell their products directly," adds Ms. Sen, "and there has been limited interest among investors in overseas funds. The returns in India have been positive over the past

year and the rupee remains generally firm. But that should change over time as diversification becomes increasingly important.”

But with a fast-growing middle class, and only around 8% of retail investable surpluses currently allocated to stock markets, including mutual funds, India is a market of huge potential. “Asset managers have to be in this market to take advantage of the rise in savings over time,” says Mr. Naganath. “Without doubt,” he says, “the best is yet to come.”

Brazil: Window Opens for International Managers

No asset management market provides such tantalizing prospects right now as Brazil. Regulatory changes in the past two years first allowed authorized investment funds and then pension funds to invest a proportion of their money abroad. While 40% of the US\$830 billion-plus of domestic assets under management is still invested in government bonds, that could be changing. “The long-term trend is for interest rates to fall,” says Mr. Veronese, Director for Securities and Fund Services in Brazil for Citi’s Global Transaction Services: “Institutional investors are starting to look for different instruments.”

The large numbers of international asset managers now descending on Rio and São Paulo will be hoping international securities make it onto the “watch” list. Pension funds alone could have US\$40 billion to US\$50 billion to invest overseas. “Very few domestic asset managers have genuine international expertise, which presents a real window of opportunity for international managers,” says Mr. Veronese.

It is not all plain sailing. Offshore funds cannot be sold in Brazil so asset managers are obliged to set up locally domiciled “international investment funds” as feeders. Asset managers must also register locally and are required to maintain a substantial presence in Brazil. The

market is highly regulated, with firms obliged to provide data to the regulator on a daily basis. To minimize the initial investment, many firms are turning to third-party administrators.

It is a mark of how far the Brazilian market has come that it is no longer just the top names from the U.S. and Europe – be it asset managers or investors – that are looking to enter the local market. Asian names now figure prominently in the mix, among them Mirae Asset Management, the big Korean asset manager. “Mirae already had an allocation to the country,” says Mr. Veronese. “A couple of years ago they opened their Brazil office. This meant they could position themselves as the only true Brazilian expert in Asia.

As the Brazilian authorities open up the international markets to domestic investors, so they are endeavoring to bring more of the international markets to Brazilian exchanges through the creation of Brazilian Depositary Receipts (BDRs). Telefonica, the Spanish telecoms company, and Dufry Group, a Swiss retailer, were among the first to list local BDRs.

“Investment in a BDR is counted as an investment abroad,” says Mr. Veronese: “The Brazilian exchange requires some of the dealing from the new outflow. It is part of an attempt to transform the Brazilian market into a worldwide hub by bringing more liquidity and more instruments into the country.”

The authorities have also been encouraging the creation of exchange-traded funds (ETFs).

One other area that is highly active at the present time, says Mr. Veronese, is the private equity market. “The main investment channel is via private equity mutual funds,” he says “With the soccer World Cup in four years’ time and the Olympics in six, there is going to be a lot of money flowing in via the capital markets. Brazil is an exciting place to be.”

Middle East: Long-Term Growth Story Remains Intact

The growth of a regional asset management industry in the Gulf Cooperation Council (GCC) countries remains a work in progress. Five years of disappointing returns since the last equity bubble burst in 2006, concerns about the world economy in general and the outlook for Dubai in particular, as well as a generally short-term outlook on the part of local investors – all continue to frustrate asset managers in the key territories.

“Regional managers do win business from international firms, with global mandates, who wish to tap into the local markets, and international fund managers continue to take assets out to invest internationally,” says Abdul Kabir Hussain, Head of Asset Management at Mashreq Asset Management, part of the UAE’s largest private bank. “But raising local money for local investment remains challenging,” he says.

He says his own firm represents a microcosm of the region’s asset management industry. “We were one of the first to launch a family of equity funds and one fixed income fund in 2005 and 2006, and almost instantly had US\$1 billion under management,” he says. “That is now down to around US\$450 million.”

The one area of recent growth is in debt funds. According to Mr. Hussain: “A variety of debt funds have been launched since the start of last year. Prior to that, Mashreq’s fund had been the only one to survive the 2008 credit crisis,” says Mr. Hussain. “We launched a Sukuk fund in June 2008, which has since returned more than 10%. The market is still dependent on international demand,” stresses Mr. Hussain.

There are encouraging signs, however. Richard Street, Director and Head of Securities and Fund Services for the Middle East and Pakistan, Global Transaction Services, Citi, says sovereign wealth funds and other public sector funds are beginning to allocate more of their assets within the Middle East region. “Importantly, they are moving money away from direct investment toward portfolio investment,” he says.

He also points to the arrival of a number of international firms: “Ten years ago, no international companies would have been managing money investing into the Middle East from the Middle East. Now a number are doing so – either directly themselves or through joint ventures.”

In many cases, international firms look to enter the region by partnering a large regional bank with established distribution. One problem they face, says Mr. Street, is that the partner bank may not have the anti-money laundering, “know-your-customer” or other key processes in place that are generally expected in more developed markets.

The region’s long-term fundamentals remain robust, says Mr. Hussain, who stresses the role regulators must play in helping the markets achieve their potential: “There is a lot of talk about the development of domestic bond markets and the consolidation of exchanges. The regulators realize there has to be a move to improve transparency and liquidity. But it will not happen overnight.”

Mr. Street agrees: “The biggest change is going to come from the opening up of markets. Saudi Arabia represents about half of the GCC markets, but remains closed to non-GCC investors – other than through mutual funds or swap arrangements. The opening up of these markets, when it comes, will mark a sea-change in their evolution as the influence of international investors and asset managers increasingly makes itself felt. The potential here remains huge.”

Markets in Transition

While the fund markets of China, India, Brazil and the GCC are clearly evolving at different speeds, they share many of the same characteristics. There is mounting private wealth –

both among a growing middle class and a super-wealthy elite. There is an emerging equity culture, which in most cases remains domestically focused. By and large, too, the regulatory environment is improving. Market liberalization is either moving ahead or firmly on the agenda.

Most of these markets have shown extraordinary resilience to the credit crisis and the economic malaise that has affected OECD nations. Even in the GCC, which has been afflicted by some of the same credit issues faced by the U.S. and Europe, huge reserves of oil wealth have been mobilized to sustain spending and growth. That these economies still march to a different drumbeat cannot be disputed.

All of which reinforces the case for asset managers to be actively involved in all four markets. The rewards will not be immediate. Distribution and market access issues will remain a challenge for some time to come and firms will need both patience and invention to make the most of the opportunities on offer. ■



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