



Picking High-Hanging Fruit: Competition Intensifies Between Asian Managers and Foreign Firms

October 2011



Foreword: Citi

Asset management opportunities in Asia have received substantial attention in recent years, and for good reason: Economic development and population growth have led to an emerging middle class and the expansion of sovereign and corporate pools of assets. Nevertheless, after an initial gold rush, local and foreign managers have awoken to the sobering reality that Asia is a very complex heterogeneous region.



With this complexity in mind, Citi is proud to join with Cerulli Associates, an independent consultant, and Mirae Asset, our client and co-sponsor of the research, in outlining how asset managers might effectively plan their distribution strategy across Asian markets.

Key findings of Cerulli's research show that much of the low-hanging fruit has been picked: Selling UCITS funds through the major financial hubs has worked to some degree, yet managers need a more sophisticated strategy as retail sales increasingly move onshore. Meanwhile, though major pension and sovereign funds offer a tremendous growth opportunity, some are actually building teams to manage assets in-house, decreasing the outsourcing mandates available to third-party managers.

Finally, the spotlight on Asia has led to intense competition between local

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Neeraj Sahai
Global Head
Citi Securities and Fund Services

and foreign managers. Even Western managers concede that local managers have advantages of language, cultural understanding and commitment to the region. At the same time, due to the heterogeneous nature of the region, local managers are increasingly finding that expansion from their home market to other Asian markets can sometimes come with the same challenges that Western managers face.

Clearly, it is an exciting time to be running an asset management business in Asia, but there are significant challenges, too. As a major provider of services to the investment community, by sponsoring this research Citi hopes to assist our clients in overcoming these hurdles.

We are pleased to provide you with the following research report prepared by Cerulli.

Foreword: Mirae Asset

Mirae Asset is pleased to sponsor this research by Cerulli Associates, who were chosen for their extensive financial experience in the Asia-Pacific region. From the outset of this project, we were confident Cerulli would help provide us with the answer to one of the key questions that we, and others in the Asian asset management industry, often ask:



Do we, as local Asian asset managers, have a substantial information advantage over Western managers toward alpha generation in the region? We believe this study goes a considerable way to providing an answer to this question.

At a time when local and Western managers are adapting to a changing Asian economy, we believe this survey provides a timely insight into the investment opportunities provided by Asian emerging markets. The research highlights how developments in emerging market products, such as high yield instruments, RMB-denominated

funds and ETFs, will likely maintain the industry's rapid growth rate. In addition, it analyzes some of the key challenges managers face in trying to establish stable distribution channels in Asia-Pacific markets.

We believe only those who have the capacity to think globally but act locally will be the victors. As a firm anchored around emerging market expertise, we recommend this study as a timely insight into the challenges and opportunities for asset managers within the region.

Sincerely,

A handwritten signature in black ink, consisting of three stylized, cursive characters.

Jae Sang Koo
Vice Chairman and CEO
Mirae Asset Global Investments



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Executive Summary

Summary of Findings

Fueled by an expanding middle class, new pools of insurance and retirement assets, and increased interest from foreign investors, Cerulli expects assets under management in Asia ex-Japan & Australia (hereafter, "Asia") to nearly double by 2015. China is likely to be the principal engine of this growth, while Korea will continue to be a considerable force. Within relatively short order, Asia could become one of the largest regions for asset management in the entire globe.

However, massive growth has led to some surprises in terms of specific product demand. In terms of vehicles, mutual funds have seen their share of overall household wealth erode from 14% in the boom times of 2007 to just 8% by 2010. This relative decline cannot be attributed to Asian buyers having less money: They just seem to be doing other things with it. While mutual fund assets may track in the growth of local economies going forward, one relative winner is the exchange traded fund, which has seen assets grow to US\$60 billion in Asia. Skeptics argue that ETFs can never become truly popular because banks – which dominate distribution in most markets – won't sell them (since there's no commission involved). Conversely, ETFs' very popularity could be a factor in eroding banks' market share, in favor of broker/dealers and independent advisors.

Western managers charging into Asia promoting developed equities are likely to be severely disappointed; such products are viewed as a low-upside, high-downside trade. In addition, UCITS promotion has become a crowded space succeeding predominantly in select markets – the hubs of HK and Singapore. The asset classes in demand are perhaps more obvious: Emerging market equities and fixed income lead the pack, be they Asia-focused or more globally oriented. For retail investors, anything offering yield is appealing, such as high yield bonds, or inflation-protected securities; principal protection and currency risk management are also in demand. In institutional

channels, pensions, insurers and sovereign funds are showing increased interest in private equity and hedge fund vehicles.

In terms of distribution, the latest news is that there is very little to report. Incidents such as the sale of Lehman mini-bonds in Hong Kong – and allegations of misselling that accompanied them – have refocused attention on the idea of advice-driven distribution. But there is little sense of independent financial advice gaining any meaningful traction as a fund management distribution force in Asia. Managers active in the region continue to expect demand for objective advice, but so far, it has yet to materialize in retail channels, where portfolio turnover remains high. Skeptics advise against fighting churn and suggest accepting it as a fact of life. Currently, the only trend that may erode the power of local banks is the continued growth of ETFs, which is being promoted more by broker/dealers and advisors due to its low fee structure.

A near majority of Western and APAC managers believe that service providers (custodians, platforms, consultants and others) can play a key role in terms of introductions or other distribution advice. APAC managers also value investment ideas sourced from service providers, while their Western counterparts are more likely to value regulatory insights.

As the Asian asset management industry continues to grow, the tug-of-war between local asset managers and Western players is intensifying. Two thirds of APAC managers believe their local relationships and cultural understanding give them a leg up over Western entrants – an assertion that Western managers don't dispute. That being said, APAC managers themselves face many of the same cultural and regulatory challenges when they expand outside their home country and across Asia. Few local managers have built large pan-Asia businesses; strong brand in Japan doesn't necessarily translate into China. In fact, most Asian managers are

quite selective, looking to target few retail markets outside their home, whereas Western managers often overextend themselves. Interestingly, declaring a victor in the competition between local and Western managers is complicated by blurring lines between the two. If a Western manager hires locally in Asia and delegates decision-making to employees on the ground, or acquires an existing indigenous manager, could one consider the resultant firm “local?”

A Look Ahead

Western managers expanding into Asia, as well as local players expanding across markets, should think locally. If the concept of “one Europe” is slippery, Asia is even less homogenous, with the dramatic difference in size, regulations, growth rates and product preferences from market to market. Asset managers should target one or two markets at a time, rather than attempting pan-Asian expansion, especially as it is becoming a chiefly onshore market.

Distribution in Asia requires planning for the long haul, particularly for foreign managers. In developed markets, a focus on profitability, rather than an asset grab, makes more sense. But given the slow easing of capital controls, and the long cycle of shifting from savings to investment, it is sometimes better to shoot first and ask questions later. This is the approach that local managers have taken, and that Western managers should consider. Building brand and distribution will take time, but continued growth in the middle class and institutional pools should offer a long-term payback.

Nobody knows how long it will take for the RMB to move to full convertibility, but the steps that have been taken so far have the whole financial services industry abuzz. The early impact has been the development of new mutual funds around dim sum

bonds – those launched in Hong Kong and denominated in offshore RMB. But at the time of writing, there was more to come: Mini-QFII could transform the power and influence of Chinese domestic asset managers. As the RMB becomes a more widely accessible and tradable currency, this will feed through into product demand, with investors increasingly seeking exposure not just to Chinese assets, but also to the currency itself. A recent visit to Hong Kong by Chinese Vice Premier Li Keqiang was immediately followed by the Ministry of Commerce’s issuance of guidelines promoting offshore renminbi (CNH) through direct investments, suggesting policymakers in Beijing view renminbi internalization as a national strategic priority.

Growing and increasingly professionalized institutions (pensions, insurance and sovereign funds) will continue to provide compelling growth opportunities, and may be the first stop for foreign managers. Local APAC managers are wise to be selective with retail expansion outside of their home markets, and focus on institutional clients. More Western players should adopt this tactic, expanding their target list to include the Chinese insurers, who are more open to external managers than some of the usual suspects (i.e., sovereign and retirement funds).

Asian asset managers are not content to simply play defense against a Western incursion, but are also looking to take on the world. Distribution flows are no longer just West-to-East: A handful of managers from China, India and Korea are making inroads into Hong Kong, Malaysia and even Western markets. Increasingly, Western investors looking to buy a Chinese equity fund are waking up to the idea that it makes more sense to buy it from a Chinese asset manager.

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Chapter 1: Introduction & Overview

Introduction & Overview

Key Findings

- **After 50 years of development, Cerulli research puts the total assets under management ex-Japan and Australia¹ at US\$2.2 trillion. While not yet significant on a world scale, a huge emerging middle class could lead Asia to eventually become the largest asset management region in the world.**
- **Asian respondents are not targeting as many markets as international managers. International players might be overambitious in attempting a pan-Asian strategy.**
- **Half of the managers surveyed judge success by asset growth, while only one third focus on profitability. For Asian managers in particular, the grab for assets is the main game, and may be a sound long-term strategy.**
- **Mutual funds assets are occupying a steadily smaller proportion of overall household wealth: from 14% in the boom times of 2007 to just 8% by 2010. This tells us that the sluggish performance of mutual fund AUM in recent years cannot be attributed to Asian buyers having less money: They just seem to be doing other things with it.**
- **With US\$60 billion in AUM according to BlackRock, exchange traded funds (ETFs) are making their presence firmly felt in Asia. But some feel that ETFs can never become truly popular as banks won't distribute them (since there's no commission involved).**

¹For HK's AUM, Cerulli has uses a proprietary model to estimate the true market size of the Hong Kong mutual fund marketplace, and this is based on multiple data sources including the HK SFC and Cerulli's own proprietary surveys. These estimates may differ from other published figures.

Asset management in Asia is 50 years old, and while there is much to be proud of, the industry has barely scratched the surface of what the report authors believe will eventually become the biggest asset management region in the world.

Until the early 1990s, asset management in Asia was largely a retail, and local, affair; but with the development of cross-border distribution by the foreign banks, open architecture began to take root and, coupled with strong economic growth and the development of a wealth management industry, retail assets under management began to grow strongly. Institutionally, the asset management industry has been a late bloomer, only professionalizing over the last decade to the point where it is now ready to take off, with very strong growth prospects ahead.

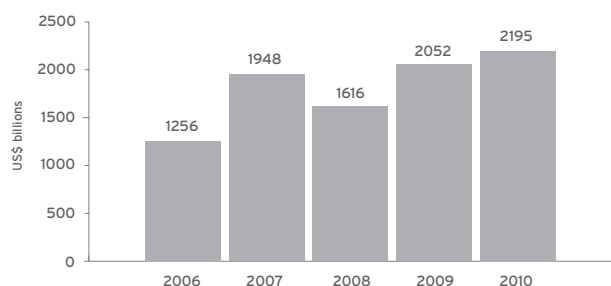
Market Sizing and Composition

The Asian asset management industry is not, by any stretch, the largest in the world, but it shows immense potential. After 50 years of development, Cerulli research puts the total assets under management ex-Japan and Australia at US\$2.2 trillion. Considering that Australia's pension fund industry alone is worth US\$1.3 trillion (a figure galvanized by a soaring Australian dollar), the numbers are not yet significant on a world scale. But all demographic factors point toward a continuing increase for many decades to come.

Most obviously, there is the shift of extremely large populations into the middle class across the region, bringing with them not only more disposable income but increased sophistication around investment. Secondly, emerging Asian nations are steadily building considerable institutional investment presences on three fronts: well-resourced sovereign wealth funds, fast-developing pension funds and increasingly a

presence from home-grown insurers. Trends in these areas will be discussed in **Chapter 2**, but the overriding message is clear: Everything points toward dramatic growth in assets in Asia for many decades to come.

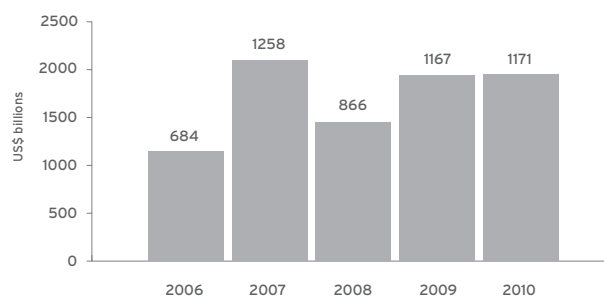
Exhibit 1: Asia ex-Japan Asset Management Industry Assets Under Management, 2006 - 2010 (US\$ billions)



Source: Cerulli Associates

The composition of Asian assets is roughly half from mutual funds and half institutional. Although volumes have nearly doubled since 2006, mutual fund growth was extremely modest in 2010, reflecting skittish investor sentiment that hasn't yet fully recovered from the financial crisis. Indeed, net new inflows were actually negative in both 2009 and 2010; the increase in industry volumes came instead from asset growth through market performance. Confidence is clearly well down on what it was precrisis, when net new inflows came to \$289.2 billion in a single year in 2007. It's possible, too, that the availability of alternatives to mutual funds – particularly exchange-traded funds (ETFs) – is beginning to have an impact, a trend that appears in other parts of the world, especially the U.S. and to a lesser extent Europe.

Exhibit 2: Asia ex-Japan Mutual Fund Assets Under Management, 2006 - 2010 (US\$ billions)



Source: Cerulli Associates

It's also notable that mutual funds have flattened off at a time when household wealth has grown. Asian household financial assets were largely unaffected by the financial crisis, growing steadily through 2008 and 2009, so correspondingly mutual funds assets are occupying a steadily smaller proportion of overall household wealth: from 14% in the boom times of 2007 to just 8% by 2010. This tells us that the sluggish performance of mutual fund AUM in recent years cannot be attributed to Asian buyers having less money: They just seem to be doing other things with it.

Product Development Trends

One of the most vibrant trends of the last two years, applicable on both the retail and the institutional sides, has been the growth of interest in emerging market product. This applies both in equities and fixed income, and within emerging markets, Asia is the most popular region – both for funds sold here, and in the developed world.

Another trend, this time chiefly for retail, has been increasing appetite for anything offering a high yield. Again, one can see this on both the fixed income and equity side of the business, with growing interest in higher-dividend share portfolios, and also high yield bonds. The interest in higher yielding fixed income ties back into the emerging market, or Asian theme: With interest rates much higher in many Asian nations than in the developed world, Asian paper offers an attractive return. Also the high yield bond market itself is staging a revival in Asia, moving beyond its traditional concentration on Chinese real estate and Indonesian coal companies to other sectors. Several managers also report a shift from equity to debt over the last year.

The search for yield is also bringing investors to Asian currencies, whether for assets denominated in those currencies, or for pure currency plays in their own right. This brings us to the Chinese renminbi (RMB) and the efforts over 2010 and 2011 to allow it to circulate offshore to a greater degree than ever before; this has been a monumental event for Asian capital markets and is steadily creating more and more of an impact on the fund management industry, too.

The RMB is in a curious phase today, halfway between being open (on the current account) and not (on the capital account), creating a currency that behaves in different ways onshore and offshore. The internationalization to date has already created a whole new bond market – the so-called dim sum market – which in turn is prompting the launch of new RMB-denominated mutual funds, and as the pool of RMB circulating offshore grows (chiefly in Hong Kong, but increasingly elsewhere too), this sub-market for fund managers will grow, too. It is helped by the near-universal assumption that RMB will increase in value over time. “You ignore RMB at your peril,” one manager sums it up. “It’s an area of enormous business potential.” Another notes, “You’re starting to see the first few UCITS funds coming out on the RMB side, which will broaden the marketability.” ‘40-Act RMB funds have also sprouted up in the U.S.

Outside of the RMB, the popularity of the carry trade in Japan continues to drive product. And generally speaking, active currency management has become a more pressing issue across asset classes: Where many investors in Asia in the past were happy to buy a U.S. dollar product, because most currencies were depreciating against it, that has clearly changed dramatically.

Inflation-linked products are also generating interest; one manager, for example, is developing an inflation-themed portfolio, investing in real assets, commodity stocks, futures, floating rate bonds and real estate stocks.

Mutual Fund Alternatives

As elsewhere in the world, exchange traded funds (ETFs) are making their presence firmly felt in Asia. According to BlackRock, total ETF assets under management in Asia-Pacific (ex-Japan but including Australia) reached US\$59.8 billion, with a further US\$1.8 billion in exchange traded products (ETPs), by April 2011, across 250 ETFs and 25 ETPs. In asset terms Hong Kong is the biggest market so far, with 53 primary listings and 83 in total from 13 providers, with assets of \$28 billion by April 2011. China and South Korea have markets that are becoming significant in size, while ETPs are likely to increase their pace of growth in Singapore and Taiwan in coming months. The Australian ETF market has had a year of considerable expansion with numerous new entrants and a mushrooming of products from just three a few years ago to more than 50 today.

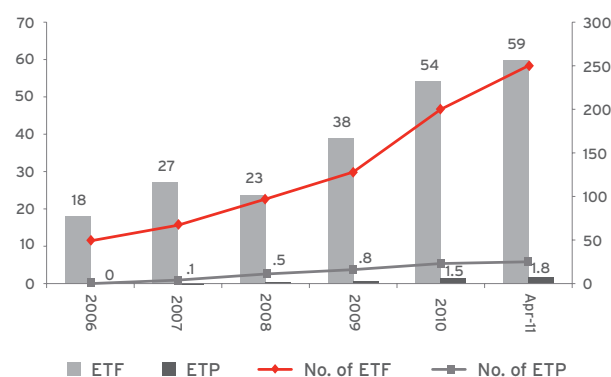
In several Asian markets ETFs are still finding their way through the regulatory process; some managers complain that their pace is too slow, a charge that comes up frequently in Hong Kong. Certainly the geared and inverse products that are, controversially, gaining traction in Europe are not yet widespread, although rules-based ETFs have started to appear.

Few feel that ETF growth will seriously damage the mutual fund industry no matter how they do, instead believing that they will contribute to a bigger overall pie of potential investments in the same way that covered warrants have in Hong Kong. But they are likely to have an interesting knock-on effect on distribution patterns. ETFs are generally not distributed by banks but by brokers. Some feel that, for this reason, ETFs can never become truly popular as banks won't distribute them (since there's no commission involved).

The other view is that ETFs are so convenient for retail investors, including the stereotypical quick-flip investor so common in markets like Hong Kong, that they should gain plenty of momentum, and may in fact be an avenue for change in distribution methods. "It's easy to underplay the potential growth of ETFs by reference to the distribution model," cautions one interviewee, "[but] that misses the fact that ETFs are really attractive products for your average retail punter." Moreover, if demand is still nascent, the supply of products is ever-increasing. "You almost can't keep up with the Chinese, Koreans and so on wanting to list ETFs in Hong Kong, along with the big international guys," notes one local player. "It's an industry that's not going to go away." If the popularity of ETFs is sustained, banks' stranglehold on distribution could be loosened in favor of broker/dealers and independent advisors.

Insurance-related products have a presence all over Asia, and in many markets, particularly Hong Kong, there is a feeling that these products have escaped some of the regulatory scrutiny that other investment products now receive. In several nations insurance and other financial products such as mutual funds are handled by different regulators.

Exhibit 3: Asia ex-Japan ETFs and ETPs Assets Under Management, 2006 - April 2011



Sources: BlackRock, Cerulli Associates

Distribution Trends

Distribution in most Asian markets is dominated by banks, accompanied in some markets by securities companies. For years there has been discussion in Asia about whether the distribution model will ever change significantly from the domination of banks that exists in most markets today. The global financial crisis did impact Asia, albeit not as badly as Western markets, and incidents such as the sale of Lehman mini-bonds in Hong Kong – and allegations of misselling that accompanied them – have refocused attention on the idea of advice-driven distribution.

But there is little sense of independent financial advice gaining any meaningful traction as a fund management distribution force in Asia (Australia, which lies outside the scope of this report, is clearly a very separate case – it is arguably the most intermediated asset management market in the world). "Are distributors

moving toward an advice-driven model, or is everything reverting back to the product push once the financial crisis noise is out of the system? The jury is still out," opines one interviewee.

Investment platforms do appear, and so do independent financial advisors, but the feeling is that in most of Asia the existing bank distribution model is so powerful it is going to take time to unseat, if it ever happens at all. "There's the odd platform that pops up, but the banks are very powerful distributors. I'm cautious on the ability of the Asia advice-driven model to start booming overnight," warns one local player.

Some feel there are cultural nuances at play here: a pattern of more speculative stock market investment rather than the long-term positions that better suit an IFA model. "A lot of Asia still doesn't have a culture of long-term equity investment. If you talk to U.S. retirees they will be holding stocks they have owned for 20 years; in Asia that's less common," explains one market observer. Pragmatists argue that rather than fighting endemic short-termism, the industry should be more realistic. "Taiwan is an enormous market, but enormous churn: a short-term sales mentality with retail product," observes one local manager. "How do you change that? You don't. You accept what it is and go in with your eyes open."

That said, regulators are generally becoming more involved in governing distribution to retail, making sure investors know exactly what they are buying. There is a sense that this will increase overall overheads at many firms, raising the bars for firms to compete. For example, Hong Kong's new Code of Conduct will require advisors to perform investor characterizations before selling products making use of derivatives, and investors will need to attend a training program in order to invest in those products. Correspondingly, some banks in Hong Kong are reportedly not putting derivative funds on their platforms. The situation is not helped by a lack of clarity on exactly what will be included in this code; if the rules apply to funds that use derivatives just for hedging, they will embrace a large part of the market.

Many fund managers find regulation like this, while well-intended, unhelpful, feeling that it covers far more funds than is necessary. As one local manager laments, "Some regulation seems a bit unfair. You could be buying the most plain vanilla fixed income fund or a geared Japanese warrant fund and end up with the same process." Another observer bemoans the effects on the investor: "As you go through the process of trying to buy a fund through a bank these days, the process is so painful it's like they're trying to put you off. If you fight through all that you might get a fund at the end of it." But the popularity of aggressive and structured products sold through the bank channel has declined considerably, not so much because of regulatory involvement as bad investor experiences during the financial crisis.

Even when managers can gain access to bank platforms, it may be harder to develop sales momentum without a strong brand. Asset servicers helping new fund managers set up in Asia highlight brand profile as extremely powerful. "It's no secret as to why Prada wants to list in Hong Kong; it is the epicenter for high-end, top brands," remarks one interviewee. "That sort of product profile is important in the fund industry, too."

That doesn't mean businesses necessarily have to be the biggest; there is plenty of cachet for niche brands, and that applies to fund management equally as fashion: Specialist Swiss banks are an example. But service providers say new entrants cannot just settle for a good product, but a brand-conscious process of marketing it, too.

Although brand is important, new and little-known names do win business, particularly on the institutional side and often in esoteric areas. One new entrant has succeeded in getting new mandates with a Russian fund, which it has also managed to sell successfully to high net worth private banking clientele in Asia. Others, trying the same approach with Brazil funds, have reportedly had a harder time; demand, particularly in the private banking channel, can be fickle and hard to read.

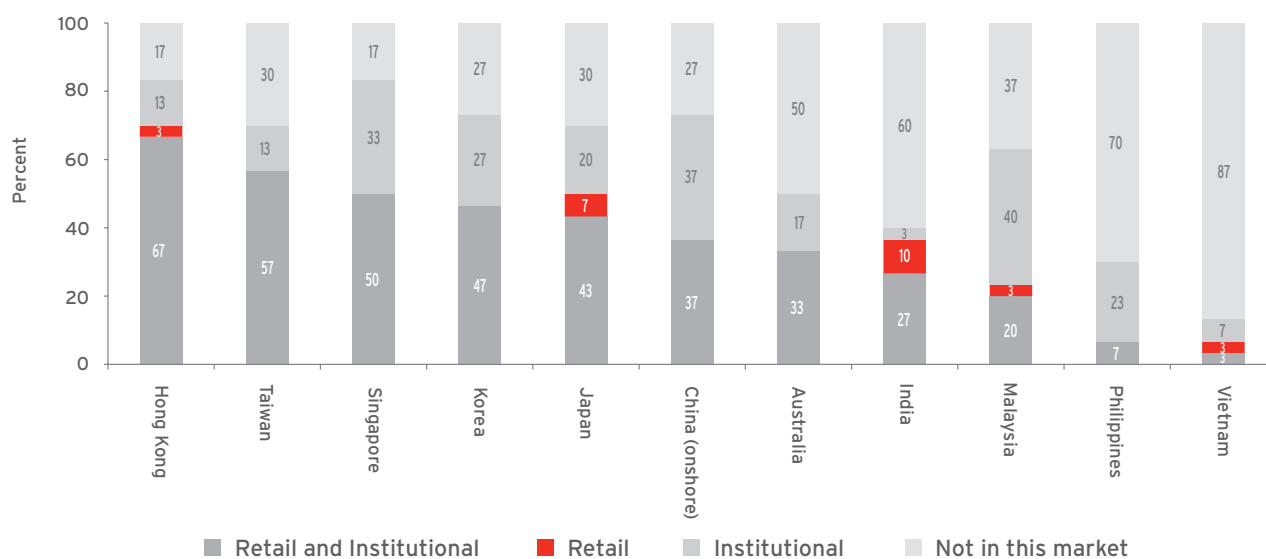
On a positive note, there are signs that a more substantive dialog is taking place between asset managers and distributors. “Post-crisis, it’s no good just to be able to say your fund went up x or y versus the index,” claims one local player. “[Distributors] want a drilldown: Why did it do that, was it duration risk, credit risk, were you long this part of the yield curve – what were the precise reasons that caused your performance or underperformance?” Similarly, simply following the crowd may not be the best solution for managers wishing to maximize distribution. “Bringing out another BRIC equity fund and assuming the distributors will want that, without reference to what the distributors themselves are hearing [is a bad idea],” according to one local manager. “I’ve heard a few times that a preferred route would be a more consultative style with the distributors.” In summary, the further development of an advice culture may hinge on the ability of managers and distributors to come together with the appropriate products, disclosures and fee structures for investors.

Survey Findings

The first objective of this survey (for details of the survey and its respondents, please see the note on the last page of this report) was to ask managers in which markets they were expecting growth – and in which segments. The picture clearly varies very much from market to market, which is a healthy development. “Prior to the crisis, a lot of people talked about Asia as one market,” explains one local player. “I think that has changed, and a lot of names coming out here do understand that it needs to be a much more targeted focus.”

In Hong Kong, Taiwan and Singapore the majority of managers intend to grow in both retail and institutional business. There is hardly anywhere where a meaningful group of people intend to grow in retail only; the only market where it is at all notable is India, where 10% of respondents are taking that approach – the only market in Asia where it outnumbers institutional-only

Exhibit 4: Profile of Survey Respondents by Target Markets and Channels in Asia, 2011



Sources: Citi SFS, Mirae Asset, Cerulli Associates

(but still less than those who voted for both retail and institutional). Malaysia is the market where foreign managers most clearly feel that institutional is the only way to go; in the main, this is because the country's EPF has increased its allocation to overseas investment, and tax incentives for managing institutional shariah funds will also help. This is interesting, because on the other hand, initiatives in Islamic finance, in particular, have sought to attract foreign mutual fund managers to set up locally with funds that one would expect to be marketed to retail as much as institutional clients.

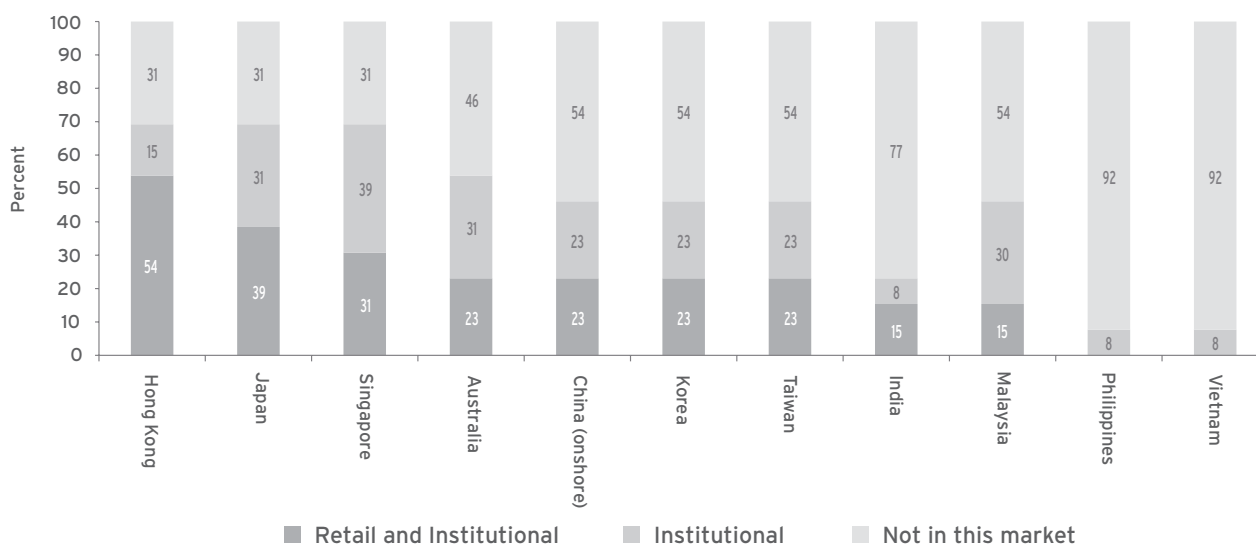
The other thing that stands out is the markets in which foreigners are not aiming to take part. Vietnam is unpopular, which is not really surprising since it has not really served fund managers well in recent years, and the Philippines is also out of favor, with thin market capitalization and less of a wealth creation story than other Southeast Asian peers. But India is notable as a market in which the majority of respondents said they were not involved, nor planning to be; this reflects the

difficulty in getting attention for offshore product, and the challenges involved in doing anything onshore. Australia, too, stood out for half of all respondents saying they had no plans to engage there, again probably because of the intense quality of competition on the ground. The markets that fewest are ignoring are Hong Kong and Singapore, which stands to reason, as they are the region's main hubs.

However, this question was put to both Asian and international respondents, so it's worth looking at how responses varied according to the location of the respondent.

Asian respondents are less likely to be in as many markets as international managers, hence the fact that in several markets the majority of Asian managers have no immediate intention to build a presence, particularly the Philippines, India and Vietnam. Absolutely no Asian fund managers said they were purely targeting retail; instead the usual position is retail-with-institutional, or institutional only.

Exhibit 5: Profile of Asian Survey Respondents by Target Markets and Channels in Asia, 2011



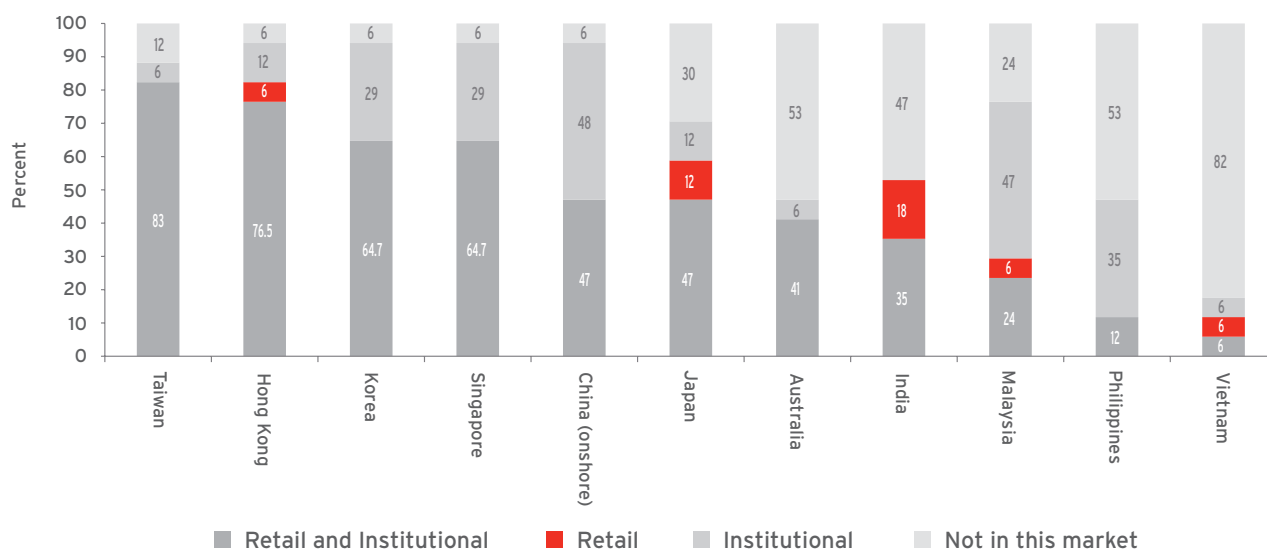
Sources: Citi SFS, Mirae Asset, Cerulli Associates

Looking at international respondents, appetite for China is very clear, with just one sixteenth of respondents not targeting the market at either an institutional or combined institutional and retail levels. Hong Kong and Singapore, unsurprisingly, are also key targets for international managers, but the popularity of Korea and Taiwan, with very few internationals not targeting them, is perhaps more striking.

International managers also appear keener to target region-wide retail investors (in combination with institutions) than Asia-based managers do. This is likely because Asian managers, while often happy to target retail in their own country, are unlikely to do so in other markets in the region because they lack the infrastructure and the products for distribution. Foreigners, having set up distribution infrastructure (including their faith in UCITS as a solution for Asia), are more likely to try their products in a range of retail marketplaces.

It is also interesting to see which markets managers are targeting outside of Asia. Most Asian managers are not targeting Latin America, Africa, the Middle East or in most cases North America; Europe is the only market in which a majority do target the region, largely through institutional-only mandates. For international respondents, the majority are targeting Europe – both retail and institutional – while almost two thirds of respondents are still interested in North America despite its economic problems. These developed blocs are more popular than non-Asian emerging markets, although more than half of respondents are interested in Africa or the Middle East, and half are also targeting Latin America.

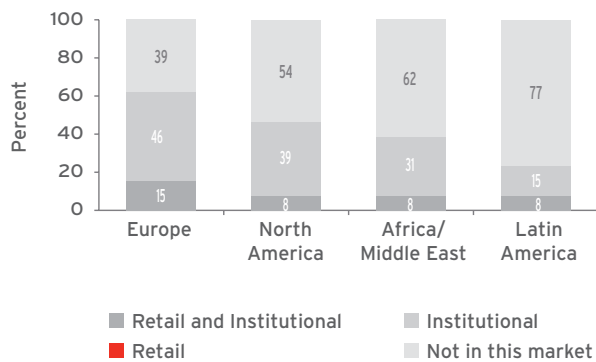
Exhibit 6: Profile of International Survey Respondents by Target Markets and Channels in Asia, 2011



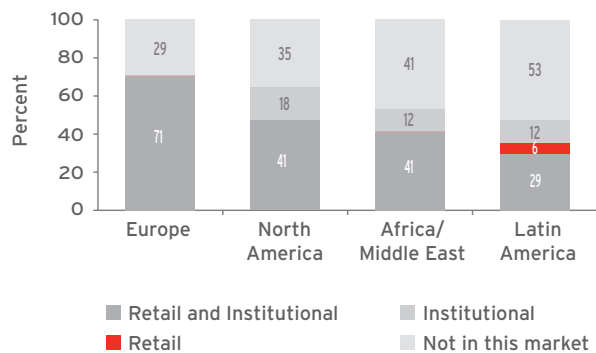
Sources: Citi SFS, Mirae Asset, Cerulli Associates

Exhibit 7: Profile of Survey Respondents by Target Markets Outside Asia-Pacific, 2011

Asian Managers



Western Managers



Sources: Citi SFS, Mirae Asset, Cerulli Associates

What makes asset managers set up in a particular jurisdiction? Most obviously, growth potential is a key

consideration: 90% of respondents said this was very important. Next on the list are clients' willingness to use foreign managers, a hospitable regulatory environment and current market size. Asset persistency – the hope that clients invest for the long run – had fewer respondents considering it very important, though many consider it somewhat important. Product mix garnered the least sentiment, although Asian managers consider this more important (and asset persistency less so) than international managers.

Exhibit 8: Survey Respondents' Views on the Primary Considerations When Deciding Which Markets to Expand Into, 2011

Factor	All Managers	Local APAC	Western
Future growth potential	90%	92%	88%
Clients' willingness to use foreign managers	66%	77%	56%
Ease of entry/hospitable regulatory environment	62%	69%	56%
Current market size	41%	46%	38%
Asset persistency (clients invest for the long run)	24%	23%	25%
Product mix	21%	23%	19%

Sources: Citi SFS, Mirae Asset, Cerulli Associates

When managers do set up, their greatest headache is Asia's sheer diversity: 32% cite the acute differences from one market to the next, while another 32% cite the regulatory hurdles of accessing those markets. The two themes are related: One of the key areas in which differences between markets manifest themselves

is in regulation. This sentiment was echoed by one interviewee: “Every country is different, so trying to run a regional structure is challenging. There’s a lot of local adaptation required to meet local regulatory requirements.”

One area widely talked about in Asia – the lack of independent advice-based distribution – doesn’t seem to concern managers too much, rather accepting it as a fact of life. International managers seem particularly unconcerned: Less than 7% mention it. The need for local connections in order to get things done is highlighted by only 14% of respondents, suggesting that this cliché, often stated outside of Asia, may not have much conviction behind it. For Asian managers, the differences from market to market are less of a concern as they are more likely to be active in only one, or few; for them, regulatory hurdles are more pressing.

Exhibit 9: Survey Respondents’ Greatest Frustration in Regional Expansion, 2011

Factor	All Managers	Local APAC	Western
Dramatic differences from one market to the next	32%	25%	38%
Regulatory hurdles	32%	33%	31%
Unexpected importance of local connections in getting deals done	14%	17%	13%
Lack of independent advisor-based distribution	11%	17%	6%

Sources: Citi SFS, Mirae Asset, Cerulli Associates

In assessing success, it’s clearly much more about asset growth than profitability; for Asian managers in particular, 62% see the grab for assets as the main game, consistent with the way that emerging markets are likely to deliver over the very long term. Only 15% of local APAC managers judge success in new markets primarily by profitability.

Exhibit 10: Survey Respondents’ Views on Measuring Success in Their Target Markets, 2011

Factor	All Managers	Local APAC	Western
Achieving AUM targets	50%	62%	41%
Achieving desired profitability	33%	15%	47%
Improved brand recognition	7%	8%	6%

Sources: Citi SFS, Mirae Asset, Cerulli Associates

This view stands in stark contrast to that of Western managers, 47% of whom see profitability as the key metric. This disparity is perhaps explained by the need for Asian expansion to be a fast-acting antidote to declining profitability for Western managers in their home market. While one could argue that a focus on costs is prudent, the need to be profitable from Day 1 could explain why some international players give up too quickly on their expansion efforts. Such impatience is usually not well received by investors or distributors. “When you come into this country, you stay in, and you don’t close the doors when things get tough,” advises one local player. “We’ve seen that too many times in Asia.”





Chapter 2: Retail & Institutional Asset Management

Retail & Institutional Asset Management

Key Findings

- **Across retail and institutional channels, a majority of managers expect increased demand for local and emerging markets products, including both equities (62%) and fixed income (61%). Inflation protection (46%) and guaranteed products (35%) are next in line on the retail side, while hedge funds (36%) and private equity (38%) are also projected to see additional flows in institutional channels.**
- **In retail channels, 52% of managers expected high demand for objective advice. Such demands were echoed by 24% who expect high demand for asset allocation, and another 21% who see demand for expertise with alternatives.**
- **China's big insurers are behemoths with agency forces bigger than the populations of many international cities. They are only going to get bigger as insurance makes greater inroads into China's vast population. Moreover, their increased investment flexibility makes them a sleeping giant for asset managers to target.**
- **While there is a great deal of discussion about shifts in attitudes toward external managers among pension funds, little has changed, with less than 20% managed externally. While pension and sovereign funds are generally getting into more distant asset classes, and appointing external managers to help them do so, they are also becoming professionalized and better resourced internally for managing core asset classes.**
- **For Western managers, institutional mandates are a win, but also, a means to an end. Such mandates provide a foothold to launch retail expansion in the future.**

Retail

Asia's mutual fund industry appears somewhat becalmed since the global financial crisis. Having almost doubled in assets in a single year from 2006 to 2007 – reaching what is still the peak for ex-Japan Asian assets under management – volumes plunged with stock markets in 2008 and have still not recovered the lost ground.

Within that headline regional figure, though, a number of other distinct stories are taking place at a local level.

The exhibit below shows how asset growth (or decline) has varied from market to market over the last five years. China has, from a low base, become the heart of the Asian mutual fund industry over that period, but its growth has been volatile: In fact, the AUM figure was almost 40% higher in 2007 than it is today. India, too, has enjoyed rapid growth, though off a still-lower base, while in the mature markets of Korea and Taiwan growth appears to have leveled in recent years (Korea being another example where volumes were higher in 2007 than they are today).

Exhibit 11: Asia ex-Japan Mutual Fund Assets Under Management by Country, 2006 - 2010 (US\$ billions)

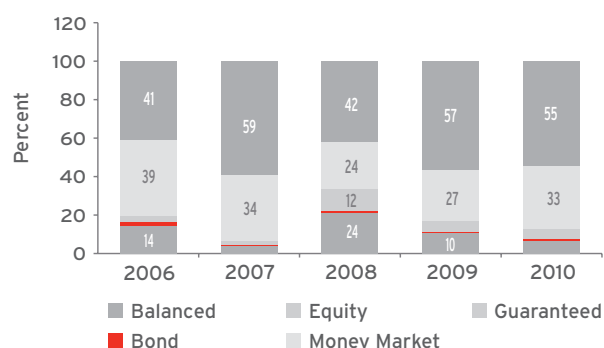
	2006	2007	2008	2009	2010
China	132	505	290	394	366
Korea	218	281	248	274	272
India	71	120	90	146	137
Taiwan	108	136	85	133	141
Hong Kong	48	71	40	58	71
Singapore	23	30	18	24	28
Other Asia	85	116	95	139	158
Asia ex-Japan	685	1,258	866	1,167	1,171

Source: Cerulli Associates

By asset class, equity funds are the mainstay of the Asian mutual fund industry, though they no longer constitute an absolute majority as they did when stock markets were soaring in 2007. There is a long-standing cultural connection with stock market investment in Asia, which helps to explain the enduring popularity of equity product among retail investors. While bond and balanced funds have remained broadly consistent, money market funds have declined as a proportion of the market in the last five years, mainly because they have fallen considerably in popularity in China.

Examining China (the biggest market) in more detail clearly shows that decline in money market funds. Bond market funds are far less prominent in China than elsewhere in Asia and the world, while balanced funds and equity are more widespread. Even after two years of fairly moribund local stock market performance, equity funds are well over half the whole market. Across all asset classes, there is every reason to expect continued growth. Cerulli projects that the Chinese fund industry's AUM will reach RMB4.8 trillion (US\$735 billion) by 2015, roughly twice its size today. This view holds that the plateau in volumes over the last 18 months has happened several times before, and has always been followed by rapid growth.

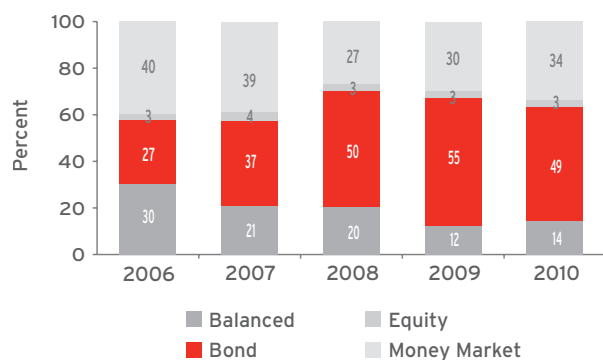
Exhibit 12: Chinese Open-End Mutual Fund Assets Under Management by Investment Objective, 2006 - 2010



Sources: Morningstar Direct, Jin Rong Jie website, Wind Financial Database, Cerulli Associates

India shares many of the same demographic drivers as China: huge population, rapidly growing middle class, increasingly sophisticated investment environment, vastly increasing disposable income across a broad chunk of the population and the steady development of the infrastructure to support a funds industry. But in terms of asset allocation, India looks very different from China, with bond funds accounting for the strongest part of the market and balanced funds barely holding any traction at all. Bond funds dominate because corporate investors and wealthy individuals, who between them hold most of the assets in India, tend to prefer these investment options for reasons partly to do with tax and partly risk aversion. Also, Liquid Plus funds – a type of money market fund – are classified as bond funds, and since banks and companies use them as a way to park short-term cash, inflows can be very high, and distort the picture somewhat.

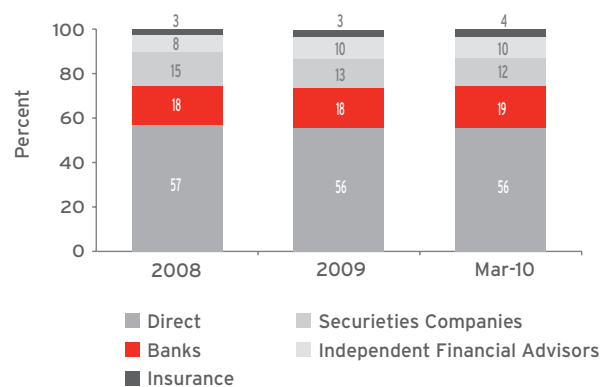
Exhibit 13: Indian Mutual Fund Assets Under Management by Investment Objective, 2006 - 2010



Sources: Association of Mutual Funds of India, Cerulli Associates

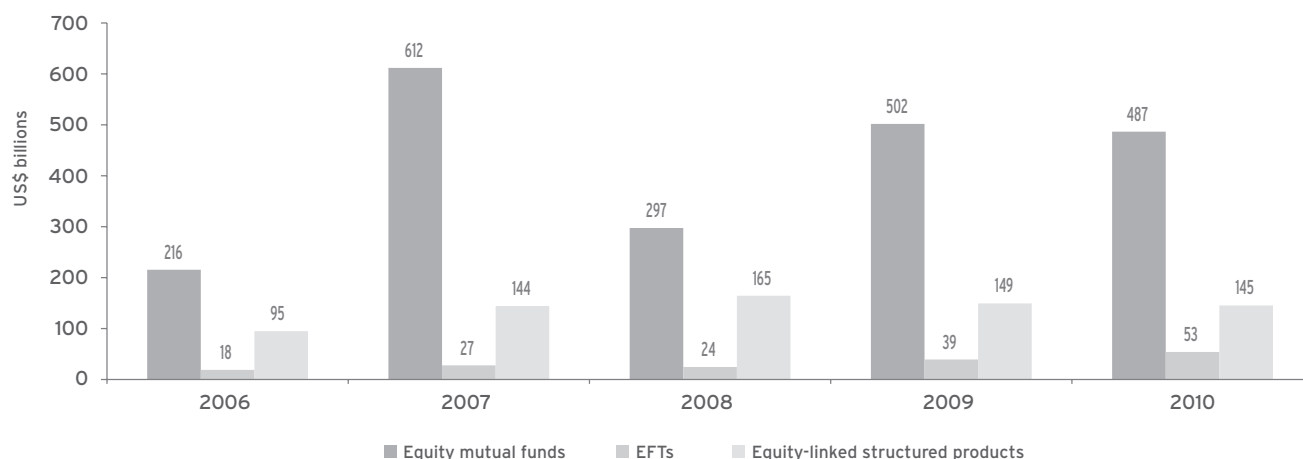
In Asia generally, retail distribution is dominated by banks and, in some markets (chiefly Korea), securities companies. For example, in China, according to Cerulli data, over 76% of mutual fund distribution is conducted by local banks. Independent financial advisors do not represent a meaningful part of the market anywhere outside Australia (which is generally excluded from the data in this survey), and despite predictions that this will inevitably change, there has been no sign of a significant shift in recent years; if anything, their penetration slipped in 2010.

Exhibit 14: Asia ex-Japan Mutual Fund Assets Under Management by Distribution Channel, 2008 - March 2010



Sources: Asset Management Association of Korea, Cerulli Associates

Exhibit 15: Asia ex-Japan Equity Mutual Fund Assets Under Management vs. Rival Products, 2006 - 2010



Sources: Arete Consulting, BlackRock, Cerulli Associates
 Note: (1) Includes assets from Japan.

Mutual funds are by far the most significant part of the retail fund structure, but from country to country there are various alternatives.

China is the most striking in this respect, because of its curious private funds industry, which operates under a different regulator than the mutual fund industry (the bank regulator rather than the securities regulator) and behaves in a quite different way.

In China, the all-powerful banks represent another competitor, through their own wealth management products. In Korea, the entrenched competitor is the securities firm industry, with their wrap accounts, whereas in India it is products that link insurance with investment. And exchange traded funds, a whole other subject, are beginning to gain momentum in Hong Kong, Taiwan and Singapore.

Across the region, real estate investment trusts are becoming more powerfully entrenched. At the end of 2010 the combined market capitalization of REITs in Asia stood at US\$93.6 billion; leaving aside Japan, whose 35 listed REITs account for \$45.6 billion of that total, Asia's total was US\$47.9 billion between

88 listings. Singapore is the most sophisticated market outside Japan: Its 24 REITs cover a wide range of different underlying assets, and furthermore have a track record of success, particularly those originated from the Capitaland group. In Hong Kong the story has been less successful, with some ill-advised financial engineering undermining the sector's appeal; in Malaysia, Thailand, Taiwan and South Korea growth has been modest but is expected to climb as various regulatory impediments are removed. In Singapore in particular they have become an attractive way for retail investors to get real estate exposure, and in that sense have arguably become competitors to the mutual fund industry.

The growth in ETFs is discussed in more detail in chapter one, but can be seen in the next chart. While still small compared to equity mutual funds, their presence is on a very obvious upward trajectory, which cannot be said for mutual funds generally. Equity-linked structured products took a dent in the financial crisis, but their presence is still meaningful, if apparently not growing. It should be said that the figure for these products, unlike others, includes Japan, somewhat skewing their actual representation.

Institutional

The development of sovereign wealth and pension funds in Asia is having a huge impact on the broader fund management business in Asia. Many sovereign wealth funds in Asia simply did not exist ten years ago, notably the China Investment Corporation and Korea Investment Corporation; and older groups like Singapore's GIC and Temasek have grown considerably in that time. Funds like these have been a large part of the attraction for many international fund managers, as have the big pension funds in the region in China, Taiwan and Korea.

As these funds have evolved, that has changed the proposition for international asset managers, too. Many funds, particularly pension funds, were purely domestic a few years ago; the increase in international investment and alternatives has created an opportunity for foreign managers.

Asia's institutional market can be divided into three segments, all of them growing. Each of these is discussed in detail below.

Exhibit 16: Types of Institutional Investors in Asia

Asian Institutions		
Sovereign Wealth Funds	Pension Funds	Financial Institutions
Temasek, Singapore	National Pension Fund (Korea)	State Administration of Foreign Exchange, China
Government of Singapore Investment Corporation	Korea Teacher's Pension Fund	Monetary Authority of Singapore
China Investment Corporation	Government Employees Pension Service	China Life Insurance Company
Korea Investment Corporation	National Social Security Fund (China)	Ping An Insurance Group, China
Petroleum Fund, Timor-L'este (East Timor)	Public Service Pension Fund (Taiwan)	
Hong Kong Monetary Authority	Labor Insurance Fund (Taiwan)	
Khazanah, Malaysia	National Pension Insurance Fund (Malaysia)	
	Government Pension Fund (Thailand)	
	National Pension System (India)	
	Mandatory Provident Fund (Hong Kong)	

Source: Cerulli Associates

Sovereign Wealth Funds

The group that tends to attract the most fanfare among international managers searching for mandates is sovereign wealth funds. There are several in Asia that fit the description, although it's always a tricky term to pin down.

They include **Temasek, Singapore**, the investment arm of the Singapore state. **Government of Singapore Investment Corporation (GIC)** is entrusted with Singapore's foreign exchange reserves. **China Investment Corporation** was founded in 2007 to make long-term investments for the Chinese state. **Korea Investment Corporation** was founded in 2005 to invest sovereign wealth on behalf of the Bank of Korea (the central bank), and the Ministry of Finance and Economy (now called the Ministry of Strategy and Finance).

Khazanah, Malaysia is of less interest to foreign managers because, rather than making external investments, its chief role is to improve the operation of the numerous Malaysian companies in which it has large shareholdings. **Petroleum Fund, Timor-Leste (East Timor)** invests oil and gas revenue for this fledgling state; much the smallest of the sovereign wealth entities but its \$7.7 billion under management is enormously significant to a deeply poor country. One could also argue that some of the funds managed by the **Hong Kong Monetary Authority**, which acts as Hong Kong's central bank, fulfill a sovereign wealth fund role.

It is a reckless business to try to bracket sovereign wealth funds together, but some themes do bind most of these names. They are generally characterized by a lack of liabilities; a general mandate of creating long-term returns for some unspecified future national good; and state backing. Beyond that, they vary considerably. Some are entrusted with foreign exchange reserves, others with influxes of cash and others with shareholdings in

companies. Some disclose assets under management, others do not; between them, these institutions are likely to have around US\$800 billion under investment management (this excludes the chunk of CIC's wealth that is invested in China's domestic banks through its Central Huijin subsidiary). Their allocations, and use of external managers, are discussed below.

Pension Funds

The second group is pension funds. These are a very clear area of growth because more and more Asian nations have seen the long-term need for a pension environment and have been building the necessary infrastructure, in terms of regulation and the formal launch of institutions, to get the process under way.

Although they often get less attention, pension funds are already in many cases far bigger than sovereign wealth funds in the same country. In Korea, for example, the **National Pension Fund** had KRW322,958 billion (just under US\$285 billion) under management at the end of 2010, compared to around US\$37 billion in the Korea Investment Corporation. And that's without considering two other powerful state-run pension funds in Korea, the **Korea Teacher's Pension Fund** and the **Government Employees Pension Service**. Part of the reason for the NPF's recent dramatic increase in assets is a state-led broadening of its coverage to much more of the national population, leading to it accumulating around US\$2 billion a month in inflows alone. This trend of increased coverage under pension fund umbrellas is being mirrored elsewhere in the region and is one of the key demographic drivers of pension fund growth.

In China, the **National Social Security Fund** had RMB856.7 billion (US\$130 billion) under management at the end of 2010; while that's less than the CIC has, it would be no surprise to see it overtake it in time.

Another key pension market is Taiwan, where pension funds – chiefly the **Labor Pension Fund** in its old and new incarnations, the **Public Service Pension Fund**, the **Labor Insurance Fund** and **National Pension Insurance Fund** – have become a potent institutional force. Malaysia's **Employee Provident Fund** is by some distance the country's most powerful institution – indeed, some in that market complain that it is too big, so heavily does it dominate local capital flows – and Thailand's **Government Pension Fund** also shows great potential for development, the more so since the government began to make a priority of ensuring greater distribution of wealth, and welfare protection, in the wake of riots representing rural people in 2010.

Thailand, with India, represents another new trend in pension funds. In Thailand, attempts are under way to launch a **National Savings Fund**, in which the government commits to match voluntary donations, a reflection of the fact that the government does not have a huge amount to build social security, and that the coverage of existing pension institutions has been too weak. Similarly, the **National Pension System** launched in India in 2009 is a voluntary contributory pension scheme, available to all Indian citizens who are not government employees. Voluntary systems like this are expected to become more commonplace.

“Relative to the U.S. and Australia, there is a lot more to do in regulation in order to be able to support a sustainable private pension fund industry in Asia,” explains one manager active in the region.

While development in pension funds in Asia to date has chiefly been state-backed, there are the beginnings of private sector involvement. Hong Kong's **Mandatory Provident Fund** system, launched in 2000, is the most

entrenched; it involves state supervision of privately operated schemes. In Korea, the Employee Retirement Savings Act (ERSA), passed in 2005, set out the principles for the establishment of employer-sponsored retirement plans as an alternative to mandatory severance payments; this developed the roots of corporate pensions in Korea. It is understood that Korean authorities expect the same growth in ERSA funds this year as in the previous four years combined. A similar program, the Enterprise Annuity scheme, has been developed in China.

While these developments are all positive, some see a pension glass half full in Asia. “Relative to the U.S. and Australia, there is a lot more to do in regulation in order to be able to support a sustainable private pension fund industry in Asia,” explains one manager active in the region. “The pace of regulation is too slow, the tax incentives are just not there, and a lot of fee regulations do not have enough protection or incentives to create economies of scale.” Though the “aging of the baby boomers” is a phenomenon well discussed in developed markets, China will also face similar headwinds, exacerbated in part by its one-child policy. “There is a mismatch between demographic drivers, and willingness, versus the pace of regulation,” explains another interviewee.

Financial Institutions

The third group is financial institutions. This can include central banks or similar institutions, for which the most high-profile example is the **State Administration of Foreign Exchange** in China, which is closing in on US\$3 trillion of reserves and is believed to have invested at least US\$350 billion of it internationally. But it also includes the insurance sector.

As in mutual funds, China has become the dominant force in investable insurance assets. Its big insurers, such as China Life and Ping An, are behemoths with agency forces bigger than the populations of many international cities, and they are only going to get bigger as insurance makes greater inroads into China's

vast population. Already they have been the region's biggest market for investable assets since overtaking Taiwan in 2007, not a position they are ever likely to give up.

China is the main reason international asset managers are increasingly enthusiastic about insurance as a source of assets, partly because of considerable recent changes in the regulation around how Chinese insurers can invest their assets. A few years ago they could invest in little other than domestic bonds; since then the net has steadily widened and today includes the possibility of offshore investments, private equity and real estate, among other things. As insurers review their allocations, they become more interesting targets for fund managers. "For years, Chinese insurance companies were very quiet, and certainly not the most productive client segment," offers one market observer. "That now appears to be changing. I wouldn't call it huge, but it's growing nicely."

Elsewhere, India is growing steadily too, while Taiwan and Korea also continue to grow steadily but at the slower pace one would expect of more developed markets. Southeast Asia makes a much more modest contribution though Indonesia's increasing economic growth and generally rising middle class make it a market to watch for the future.

Institutional Investment Trends

Most – but not all – fund managers feel that as Asian institutions have developed more wealth, they have also grown in sophistication. This comes through in many ways from allocation and outsourcing decisions to the overall modeling of the business.

Asian nations have witnessed the challenges that their European counterparts – and, closer to home, Japan – have faced in attempting to meet their deficiencies in pension liability coverage, and have sought to strengthen their own pension funds, both in terms of coverage and levels of contributions. Asset servicing groups say that clients like these are requesting

more complex services in Asia, in terms of high-end analytics, valuation-type modeling and drill-down into performance.

"For years, Chinese insurance companies were very quiet, and certainly not the most productive client segment," offers one market observer. "That now appears to be changing. I wouldn't call it huge, but it's growing nicely."

When it comes to modeling of assets versus liabilities, the picture is varied. Larger funds in Korea, Japan and Taiwan have long had asset-liability assessment models and are becoming more sophisticated at doing so; those who work with them say they are starting to use more international styles of looking at different economic scenarios and working out how they would affect their liability structure. The struggles of sectors like the UK pension industry have amplified the need for dynamic management.

External managers note an increasing use of models that separate alpha and beta, and delineate how much to put into passive and alternative investments. Other areas of sophistication include the growth of securities lending to generate additional income; and increased interest in international assets. In Taiwan, for example, there is a very large proportion of international allocations in pension assets: perhaps as high as 35% to 40%. And other institutions, in Korea and Malaysia for example, have voiced an intention to move more assets overseas. Generally, pension funds are reviewing allocations between developed and emerging markets, increasingly in favor of the latter.

Another pattern is that pension funds traditionally dominated by debt investments are looking more at equity, and from there to a greater range of asset classes. Again, Korea is representative here. The

National Pension Service, which runs the NPF, has voiced plans to put as much as US\$4 billion into alternative assets such as hedge funds, private equity and infrastructure. Post-Madoff, there are operational concerns, but as one interviewee explains, “The smart money has gone into hedge funds and the hot money gone out.”

In the last four years overseas equity has become a fixture in its allocations (it has been in overseas fixed income for some time), and the NPS is aiming for overall investments in overseas assets to reach 20% by 2015, from 13% when last disclosed at the end of 2010. NPS has been increasingly noted for its high-profile real estate and infrastructure investments, which have included stakes in Gatwick Airport and a pipeline developer owned by Chevron.

Sovereign funds have been making such investments for longer; generally it is easier for them to go for long-duration, low-liquidity assets, since they lack liabilities. Singapore’s GIC, for example, is in its own right one of the largest real estate investors in the world, and is considered a highly sophisticated backer of hedge funds and private equity. As of March 31, 2010, it had 25% of its assets in alternatives including real estate, and 10% in private equity, venture capital and infrastructure alone. Elsewhere, the CIO of KIC in Korea has said 20% is a good ceiling for alternative assets for that sovereign fund. And in terms of the emerging markets trend, Temasek, also from Singapore, is a classic example of sovereign funds being way ahead of the curve: Its target geographical allocation now is 40% to Asia, plus 30% to Singapore, and a further 10% to “other” emerging markets (chiefly Latin America). Only 20% goes into developed OECD markets.

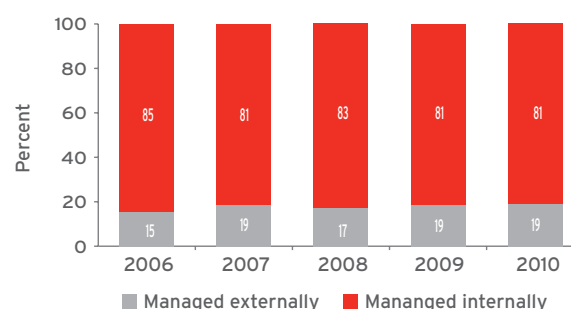
External Mandates

While there is a great deal of discussion about shifts in attitudes toward external managers among pension funds, the next chart shows that, in aggregate, little has changed, and less than 20% is managed externally. While this consistency may appear strange with so

much change happening in pension funds themselves, one reason is that two competing trends are cancelling each other out. While pension funds are generally getting into more distant asset classes, and appointing external managers to help them do so, they are also becoming better resourced internally and are able to bring the more straightforward asset classes – domestic bonds, for example, or passive parts of the portfolio – back in-house. “Pension funds started with external asset managers, then they started to build up their internal capabilities, because managing money through external mandates doesn’t necessarily guarantee the best performance,” claims one local expert. Note that this internalization applies primarily to large pension and sovereign funds, and stands in contrast to the increasing externalization of insurance fund mandates.

While growing in-house sophistication at pension and sovereign funds is not great news for external fund managers, the growth in the overall pool of assets may compensate. On a relative basis, Western managers find such opportunities appealing, compared to the anemic state of pension schemes in developed markets.

Exhibit 17: Asia ex-Japan State Pension Assets by Internal vs. External Management, 2006 - 2010



Source: Cerulli Associates

Note: Externally managed assets includes outsourced mandates and mutual fund investments

Recent examples of publicly outsourced mandates include China’s NCSF (the body that runs the NSSF),

which in June announced it was launching a series of request for proposals (RFPs) for offshore investment mandates: in emerging market bonds, multi-asset allocation, global resources active equity and global real estate active equity. This request for pitches stipulated that firms must have six years of experience in asset management and AUM of at least US\$5 billion, as well as a track record in a product relevant to the particular mandate for at least three years.

The NCSSF announcement is representative in that it shows an evolution away from the straightforward toward the more specific. Previous offshore investments have involved developed market equities, emerging market and regional equities and money market funds. The multi-asset mandate is particularly interesting: It can include bank deposits, treasuries, offshore RMB bonds, equities, fund products, money market and

derivatives – in other words, it is open to a customized approach. The resources mandate can be seen as an effort by the fund to insulate itself against inflation, and in this respect too it is representative. Also, the shift toward offshore investments is typical: Today NSSF has about 7% of assets overseas and is understood to be targeting 20% by 2015.

A look at individual pension funds shows where some of them are giving out mandates. Some clear patterns are that most funds will go external when they invest in international asset classes, but are generally less likely to do so on domestic investment (though the biggest, Korea's National Pension Fund, is an exception).

Where outsourcing does take place, there is greater usage of formal RFP processes, use of custodians and transparency of processes.

Exhibit 18: Scope of Mandates for Asian Pension Funds

		Scope of Mandates	
Country	Pension Fund	Domestic	Overseas
China	National Social Security Fund	Equity, Fixed Income, Balanced	Global Equity, U.S. Equity, Hong Kong Equity, Global Bonds, Money Market, Overseas Listed Chinese Equity, Asia-Pacific ex-Japan Equities, Emerging Market Equity, Europe Equity
Korea	National Pension Fund	Equity, Fixed Income	Equity, Fixed Income, Alternative Investments
	Korea Teachers' Pension Fund		Equity, Fixed Income
	Government Employees Pension Service		Equity, Fixed Income
Taiwan	Public Service Pension Fund	Equity	Balanced, Enhanced Index, Global Equity, Global Fixed Income, Asia-Pacific Equity
	Labor Pension Fund – old	Equity	International Balanced, International Bond, International Equity, Asia-Pacific Equity
	Labor Pension Fund – new	Equity	International Bond, International Equity, Asia ex-Japan Equity, Global Passive Equity
	Labor Insurance Fund	Equity	Global Equity, Global Fixed Income, Europe Equity, U.S. Equity, Japan Equity, Global Emerging Markets Equity, Global Passive Fixed Income, Global Bonds
	National Pension Insurance Fund	Equity	None
Malaysia	Kumpulan Wang Persaraan (Diperbadankan)	Equity, Fixed Income, Private Equity, Direct Investment	
Thailand	Government Pension Fund	Fixed Income, Equity	None

Source: Cerulli Associates

Sovereign wealth funds also vary widely in their use of external mandates. Temasek, for example, issues hardly any; it is in some respects more of a private equity investor in its own right, and it has its own in-house asset management business, Fullerton, to handle any portfolio investment it needs (Fullerton is a fully fledged asset manager offering mutual funds and institutional mandates, too). Staying in Singapore, GIC is considered one of the most able and sophisticated sovereign wealth funds in the world, able to do most things internally with a world-class investment staff; these days it tends to give out new mandates only in new and distinct areas it can't do itself, and in particular in alternative asset classes.

Newer sovereign funds have tended to start out by allocating a lot externally, with the apparent intention of bringing a lot of the advice back in-house as the expertise is developed. This is already, visibly, the approach of Korea's KIC; it has steadily moved into new asset classes year by year, always starting by giving the work out in external mandates, while gradually building internal competence in order to take much of it back again. Today, the biggest area of new mandates for KIC is in alternatives. One sees a similar pattern taking shape at China's CIC as well.

For Western managers, institutional mandates are a win in themselves, but also a means to an end. "Entry into this part of the world is being driven from the public sector space: sovereign wealth funds and pension funds," explains one local player. "The institutional mandates are, for a lot of these new fund houses, their foot in the door." Institutional mandates – while not easy to come by – can provide the cover to launch a higher-overhead retail strategy in the future.

Survey Findings

Respondents were asked where they expected to see increased demand, which yielded a number of interesting observations.

Let's start with retail. Firstly, there is great appetite for anything with an Asian or broader emerging markets flavor. Exactly 62% of respondents expect Asian and emerging market equities to be in high demand with retail clients in the next two years. This regional appeal also applies to the fixed income side, and is in stark contrast to their peers in the developed market: Not one respondent expected high demand for developed market equity, and the bulk of respondents expect low demand in developed market fixed income.

In other asset classes, views are less decisive. Two areas of clear momentum are inflation-linked products (seen as an area of "high" or "moderate" retail demand by a combined 86% of managers) and ETFs. Inflation is an important theme in Asia: Whereas developed markets are worrying about how to revive growth, in Asia for some time the debate has instead been about how to curb inflationary pressures. In some markets, like Vietnam, the situation is extreme; in others, like Indonesia, China and India, it is certainly cause for concern. Investments that hedge this risk, or even seek to benefit from it, are very much in vogue. ETFs are discussed in more detail in **Chapter 1**.

While alternative assets like hedge funds and private equity clearly have some traction, opinion is notably divided on the likely amount of demand for them; in private equity in particular the bulk of respondents see little demand, but there are enough believers out there to sustain a market. Guaranteed products present an almost perfectly polarized set of views about whether there will be high, moderate or low demand.

Exhibit 19: Survey Respondents' Views on Retail Client Product Demand Over the Next Two Years, 2011

Retail

	High demand	Moderate demand	Little demand
Asian equity	62%	38%	0%
Emerging market equity	62%	35%	3%
Emerging market fixed income	61%	32%	7%
Asian fixed income	57%	21%	21%
Inflation protection (commodities, TIPS, hard currency)	46%	42%	12%
Guaranteed products	35%	39%	27%
ETFs	30%	52%	17%
Hedge funds	12%	48%	40%
Private equity	12%	32%	56%
Developed market fixed income	11%	32%	57%
Developed market (U.S., Europe) equity	0%	66%	35%

Sources: Citi SFS, Mirae Asset, Cerulli Associates

On the institutional side, emerging market and Asian products are similarly in favor, though managers see comparatively less demand from institutions for Asian fixed income (44%) than from retail (57%). Also like retail, managers expect institutions to show little appetite for the developed world in the next two years: Zero survey respondents expect high demand for developed equities in retail channels, while only 15% anticipate high demand in institutional channels. "At this point, there's not risk appetite there for equities," remarks one interviewee. "If it's there at all, it's for Asia more than global."

It is noticeable, though, that managers expect institutions to be three times more interested in hedge fund and private equity than retail, and much less in guaranteed products, which are rarely a mainstay of institutional portfolios.

Exhibit 20: Survey Respondents' Views on Institutional Client Product Demand Over the Next Two Years, 2011

Institutional

	High demand	Moderate demand	Little demand
Emerging market fixed income	59%	30%	11%
Asian equity	56%	37%	7%
Emerging market equity	56%	37%	7%
Asian fixed income	44%	41%	15%
ETFs	41%	36%	23%
Private equity	38%	58%	4%
Hedge funds	36%	52%	12%
Inflation protection (commodities, TIPS, hard currency)	33%	63%	4%
Developed market (U.S., Europe) equity	15%	59%	26%
Developed market fixed income	11%	48%	41%
Guaranteed products	8%	29%	63%

Sources: Citi SFS, Mirae Asset, Cerulli Associates

It's worth looking at how these opinions vary depending on whether it is an Asian or an international asset manager doing the voting. Asian investors are more bullish on Asian equity but much less on Asian fixed income. They think even less well of developed markets than international managers do. International managers, by contrast, are almost universally bullish on Asian fixed income, especially for retail. Why should this be? It is likely because international investors are comparing available yields with those in their more traditional markets in the West; in that context Asian fixed income looks very much the place to be.

Exhibit 21: Asian Managers' Views on Product Demand Over the Next Two Years, 2011

Retail

	High demand	Moderate demand	Little demand
Asian equity	75%	25%	0%
Emerging market equity	67%	25%	8%
Emerging market fixed income	55%	27%	18%
Inflation protection (commodities, TIPS, hard currency)	50%	33%	17%
Guaranteed products	46%	46%	9%
ETFs	27%	55%	18%
Asian fixed income	18%	46%	36%
Hedge funds	18%	55%	27%
Private equity	17%	42%	42%
Developed market (US, Europe) equity	0%	75%	25%
Developed market fixed income	0%	36%	64%

Institutional

	High demand	Moderate demand	Little demand
Asian equity	82%	18%	0%
Emerging market equity	64%	36%	0%
Emerging market fixed income	55%	36%	9%
Inflation protection (commodities, TIPS, hard currency)	50%	30%	20%
Guaranteed products	27%	64%	9%
ETFs	27%	64%	9%
Asian fixed income	27%	64%	9%
Hedge funds	18%	55%	27%
Private equity	18%	64%	18%
Developed market (US, Europe) equity	0%	55%	46%
Developed market fixed income	0%	60%	40%

Sources: Citi SFS, Mirae Asset, Cerulli Associates

Exhibit 22: International Managers' Views on Product Demand Over the Next Two Years, 2011

Retail

	High demand	Moderate demand	Little demand
Asian fixed income	82%	6%	12%
Emerging market fixed income	65%	35%	0%
Emerging market equity	59%	41%	0%
Asian equity	53%	47%	0%
Inflation protection (commodities, TIPS, hard currency)	43%	50%	7%
ETFs	33%	50%	17%
Guaranteed products	27%	33%	40%
Developed market fixed income	18%	29%	53%
Private equity	8%	23%	69%
Hedge funds	7%	43%	50%
Developed market (US, Europe) equity	0%	59%	41%

Institutional

	High demand	Moderate demand	Little demand
Asian fixed income	63%	31%	6%
Emerging market fixed income	63%	25%	13%
Emerging market equity	50%	38%	13%
Asian equity	46%	54%	0%
Inflation protection (commodities, TIPS, hard currency)	43%	43%	14%
ETFs	39%	62%	0%
Guaranteed products	38%	50%	13%
Developed market fixed income	33%	42%	25%
Private equity	19%	44%	38%
Hedge funds	14%	7%	79%
Developed market (US, Europe) equity	13%	56%	31%

Sources: Citi SFS, Mirae Asset, Cerulli Associates

Beyond asset classes, managers were also asked which services are likely to be in greatest demand in the next 24 months in retail and institutional channels. For retail channels, advice, training and planning is the standout; This may reflect asset managers' hopeful view that an advice-based model must surely be coming to Asia, or it may reflect a growing sense that distributors and fund managers ought to talk to one another more in order for managers to educate distributors on product, and distributors to be able to pass on their own feedback about what people actually want. However, this is likely wishful thinking on the part of asset managers, the greatest victims of fund-churn. As discussed in Chapter 1, banks' grip on distribution remains solid, constraining any widespread adoption of objective advice for the foreseeable future.

On the institutional side, the demand for services is expected to be broadly based. Unsurprisingly, expertise with alternatives, derivatives management and liability-driven investments are expected to be much bigger issues for the institutional marketplace; those who deal with pension funds frequently say that liability management models are becoming steadily more sophisticated among that client base.

Exhibit 23: Survey Respondents' Views on Services Demanded Over the Next Two Years, 2011

Retail

	High demand	Moderate demand	Little demand
Objective advice, training, or planning	52%	44%	4%
Asset allocation	24%	56%	20%
Expertise with alternative investments	21%	42%	38%
Securities lending	9%	4%	87%
Liability-driven investments	8%	25%	67%
Derivatives management	5%	23%	73%

Institutional

	High demand	Moderate demand	Little demand
Expertise with alternative investments	48%	44%	9%
Asset allocation	32%	60%	8%
Liability-driven investments	28%	56%	16%
Objective advice, training, or planning	27%	55%	18%
Derivatives management	27%	50%	23%
Securities lending	13%	30%	57%

Sources: Citi SFS, Mirae Asset, Cerulli Associates

Managers were also queried on where they get the most value from service providers, and the answer was overwhelmingly related to distribution. Fund managers coming into the region generally know their stuff from a product perspective (or believe they do); naturally their biggest concern is working out how to get that product out there into the market. Among total respondents, 33% of local Asian managers show a greater appreciation of investment ideas, while only 12% of international managers see this as a critical value-add. Instead, 35% of international managers appreciate help on the enormously diverse regulator environments in Asia.

Exhibit 24: Survey Respondents' Views on the Most Critical Value-adds from Service Providers, 2011

Factor	All Managers	Local APAC	Western
Distribution advice & introductions	45%	50%	41%
Regulatory Insights	24%	8%	35%
Investment ideas	21%	33%	12%
Thought leadership	7%	8%	6%



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Chapter 3: Local vs. International Managers: Competing for Asian Assets

Local vs. International Managers: Competing for Asian Assets

Key Findings

- **The idea that Western managers can launch UCITS strategies to build an Asia business overnight is becoming an urban myth. Competition is fierce, and the real growth is taking place onshore.**
- **Exactly two thirds of APAC managers believe their local roots give them a leg up over Western entrants. Local players understand the culture, have key relationships and can get in to see top management at the corporations in which they invest.**
- **That said, APAC managers face many of the same cultural and regulatory challenges when they expand intra-Asia. Few local managers have built large pan-Asia businesses; strong brand in Japan doesn't necessarily translate into China.**
- **Declaring a victor in the competition between local and Western managers is complicated by blurring lines between the two. Having previously overloaded with ex-pats, Western managers are increasingly hiring locally and researching target markets for years before taking the plunge.**
- **Asian managers are going to take on the world. Distribution flows are no longer just West-to-East: A handful of managers from China, India and Korea are making inroads into Hong Kong, Malaysia and even Western markets. Investors looking to buy a Chinese equity fund are likely to buy it from a Chinese asset manager in the future.**

Despite its relatively small share of global assets under management, Asia is home to most of the world's largest asset management firms – many of whom are well entrenched into multiple local markets, competing head-to-head with the local asset management industry.

Asia is chiefly an onshore market (where funds sold locally are also domiciled locally), as opposed to an offshore market (where funds sold locally are domiciled in a foreign market). This is particularly true in the most powerful markets of them all: China and India. In those locations, regulation has served to support development of the homegrown industry, with foreign participation very much on China and India's own terms. Nevertheless, an increasingly strong cross-border marketplace is developing: Hong Kong and Singapore in particular are acknowledged hubs for international funds, while Taiwan has long been known for the presence of offshore funds. And, while international fund managers are the obvious beneficiaries of a cross-border environment, Asian asset managers are gradually moving toward more regional roles.

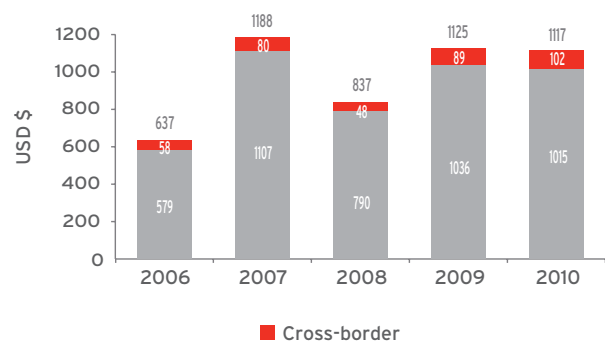
Onshore Versus Offshore

The balance in favor of onshore funds in Asia ignores some conflicting undercurrents. That's because China's market, which is entirely onshore, takes up a large part of the figures. While cross-border assets have more than doubled since 2008, they only represent a slight increase today on 2007 and there is debate as to how big a proportion of the overall total they can ever come to represent.

Outside of the hubs of Hong Kong and Singapore, within which cross-border funds thrive, funds are predominantly not just locally domiciled but locally invested, too. Again, China is a large part of the reason these statistics are so one-sided: For domestic Chinese investors, putting money into international funds is both difficult (only a limited number of international equity funds have been permitted within China), historically unsuccessful (the

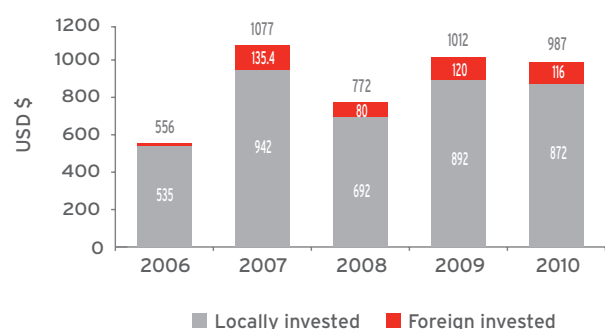
earliest funds were launched just in time to be hit by the global financial crisis) and faces another headwind: Since the RMB is widely expected to increase in value, any return from overseas assets will have to outstrip that increase just to break even in local terms.

Exhibit 25: Asia ex-Japan Mutual Fund Assets Under Management by Investment Geographic, 2006 - 2010



Source: Cerulli Associates
 Note: Analysis does not include Hong Kong.

Exhibit 26: Asia ex-Japan Locally Domiciled Mutual Fund Assets Under Management by Foreign Exposure, 2006 - 2010



Source: Cerulli Associates
 Note: Data analysis excludes Hong Kong and Singapore.

To see why China has such an impact on these statistics, it is useful to take a closer look at the Chinese market itself. China Asset Management, with US\$30.4 billion under management in 2010 (well down on 2009), has more assets under management than several Southeast Asian countries' entire mutual funds markets. While these managers do have some overseas-invested funds, that is largely a trend for the future; in the main they have built their mass on domestic assets and domestic investors.

India tells a similar story, with Reliance Capital Asset Management boasting US\$22.5 billion under management in 2010 (again well down on 2009) and several managers already well over the US\$10 billion mark. Again, India is an overwhelmingly onshore, domestic market.

Foreign Managers and UCITS

In markets where offshore funds are available, many international managers have launched UCITS-compliant funds, domiciled in Luxembourg or Dublin. In 2008 – in a finding so eye-catching it has been somewhat doubted – a study by the European Fund and Asset Management Association (EFAMA) found that 90% of net sales of UCITS in Luxembourg and Ireland were sourced from Asia, although more recent statistical updates have put Asia at a more sober 35%. Cerulli research put the total volume of cross-border funds sold in Asia ex-Japan at US\$101.8 billion as of 2010.

Three markets stand out for the penetration of these funds: Hong Kong, Singapore and Taiwan, in all cases driven by regulatory acceptance. Hong Kong and Singapore, as hub financial service centers, are natural homes for cross-border funds.

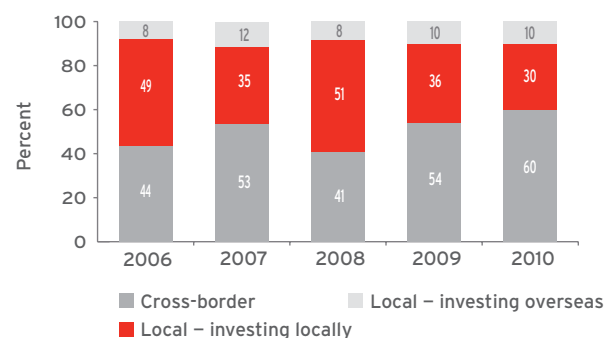
Taiwan is the stand-out significant domestic market – as opposed to an island hub – to have embraced offshore funds. It passed regulations governing offshore funds in August 2005. According to the Securities Investment

Trust and Consulting Association of Taiwan, there were 1,019 offshore funds for sale in Taiwan at the end of December 2010, with assets of NT\$2.4 trillion, compared to 555 onshore funds worth NT\$1.6 trillion; that means 59% of the Taiwanese market is offshore.

Several international fund managers say that Taiwan is where they make much of their money. That said, there are signs that the Taiwanese regulator, the Financial Supervisory Commission, is trying to redress the balance in favor of onshore funds. A new fee disclosure rule has, since March, required all funds to disclose the commission fees they award to bank distributors, which at as much as 3% are often twice as high as those from onshore funds. Foreign managers say they are also under several new requirements: An offshore fund has to be a minimum of \$100 million before it can be registered, high yield funds are no longer being approved, the length of time for approval of funds has doubled from a typical three months to more like six or seven, the number of funds that can be applied for has dropped from five to three and the percentage of Taiwanese holders in a fund has been reduced. It all adds up to a clampdown on offshore business that is perceived to be intended to help grow the local side.

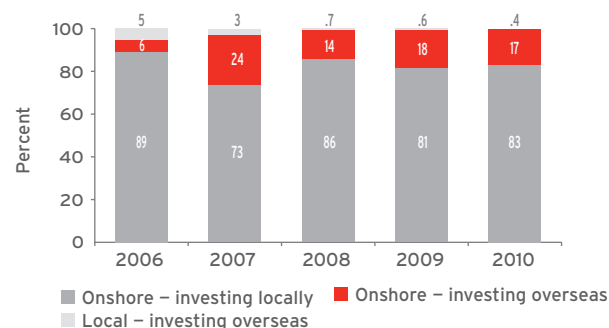
In some other markets, UCITS funds are not only not common, but impossible to sell. Malaysia, Thailand and the Philippines prohibit the direct sale of UCITS (although in Malaysia Islamic fund regulations provide a twist on this, allowing Islamic offshore funds from Hong Kong and Dubai's DIFC). Thailand and the Philippines do allow offshore funds to be sold, provided they go through a local construct. In Korea, they've been permitted since 1996, but can gain little traction against onshore competition (indeed, the finance ministry has actively given onshore funds an easier ride than offshore, opting in 2007 to give onshore funds an exemption from capital gains taxes for three years, but not offshore).

Exhibit 27: Taiwanese Mutual Fund Assets Under Management by Domicile, 2006 - 2010



Sources: Securities & Investment Trust Consulting Association, Lipper FERI, Cerulli Associates

Exhibit 28: Korean Mutual Fund Assets Under Management by Domicile, 2006- 2010



Sources: Asset Management Association of Korea, Cerulli Associates

How about the great future markets of China and India? As usual, it's not straightforward for offshore managers. The only way a UCITS fund could be sold in China is through the qualified domestic institutional investor (QDII) scheme, which grants occasional quota to managers. That quota is limited, unpredictable and comes with regulatory constraint. In India, too, direct sales of offshore funds are not straightforward, operating under quota and commonly through feeder fund structures.

What does all this mean for foreign manager strategy? Many international managers use a model of launching their funds under UCITS and this is undoubtedly effective, but perhaps not as widely as people expect. It certainly works in a highly internationalized market like Singapore, but in other domestic markets will not make so much difference.

Quite apart from the barriers to use in many local markets, there is another issue: Since it is an efficient mechanism with wide application, it is an extremely competitive area. "One thing I've experienced is this assumption that you can come in, offer UCITS funds, and hey, presto, you've got an Asia business," notes one local player wryly. "That is a very crowded space, and it is easy to underestimate the importance of looking outside the hubs to launch and run local funds in Taiwan or Korea or India." In terms of locally domiciled product, the groundwork is greater in launching and marketing them, but fewer people are attempting to sell them.

Local Managers and Regional Expansion

One interesting trend is Asian asset managers moving offshore. Mirae Asset, headquartered in Korea and offering emerging market focused products worldwide, is probably the most well-known example of this; it now has offices in seven locations globally outside of Korea and has launched several products with a Luxembourg domicile, including funds for Korean and Chinese equity, Asia-Pacific equity and global emerging markets with some funds focusing on the beneficiaries of the consumption boom of the emerging markets. As well as its locally domiciled funds in Korea, Brazil, India and the U.S., it has launched a Korean equity fund in Japan in partnership with Daiwa Securities. Moreover, in pursuit of boosting its foothold in Greater China, Mirae Asset has recently acquired TLG Asset Management, which has now been rebranded Mirae Asset Global Investments (Taiwan).

Interestingly, Mirae Asset says its offshore funds with the biggest assets under management are Luxembourg-domiciled, which suggests the advantages of the format for the right kind of fund and also creates a clear road map for other local managers to follow. It would not be a surprise to see much more regional ambition from home-grown managers.

In particular, the emergence of Chinese asset managers is seen as a highly significant trend for international managers. They are seen as aggressive in coming to Hong Kong, which is expected to be just the start of a

phase in which they seek to become broader Asia-based emerging market players, with global ambition. Simply selling, for example, mainland Chinese equity products to a global audience, whether through sub-advisory mandates or their own funds, would doubtless find a huge audience willing to tap into the research capability these institutions have onshore. The long-awaited mini-QFII program, which is expected to allow Chinese managers to set up in Hong Kong, gather funds in offshore RMB and invest them in the domestic markets, will be a pivotal process in this trend. India, too, ought to be expected to be a source of local managers going regional; Reliance Asset Management's license for Islamic fund management in Malaysia is a case in point. Recapping the activity, one local player notes, "We're seeing growth in Korean names starting to expand; in Hong Kong we've got an avalanche of Chinese houses setting up in Hong Kong as their beachhead for further expansion offshore; and the internationalization of the RMB will drive an enormous amount of interest."

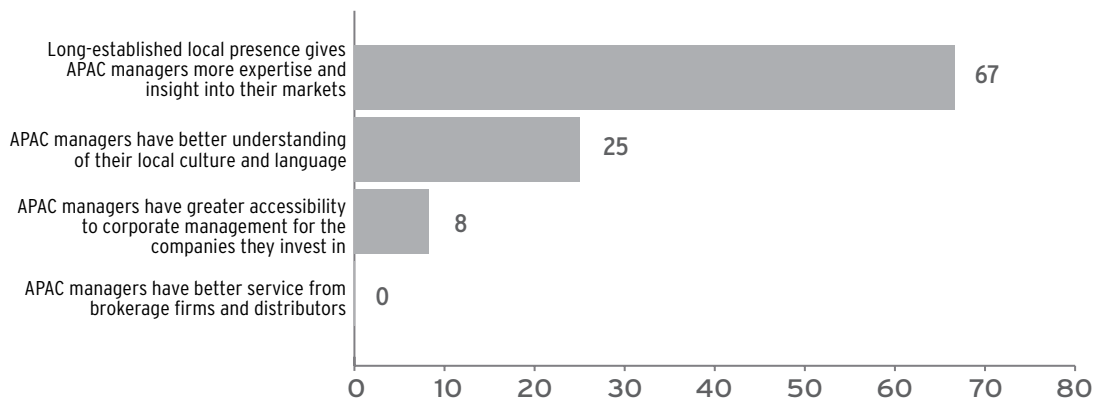
Local managers argue that they have a distinct advantage in generating alpha in their markets, because of their closer knowledge and better access to local companies, their understanding of cultural nuances and their general understanding of market behavior. "Asian asset managers moving offshore is an interesting trend, and it's going to get more and more interesting as we see how it plays out," argues one local manager. "If you are looking to buy a Chinese equity fund, buying it from a Chinese asset manager may be a pretty smart idea."

That said, there are clear challenges involved in local managers building regional businesses. The same unfamiliarity of regulation, culture and language apply equally to a firm from one Asian nation setting up in another as they do for a foreign house setting up in Asia. Local asset managers also tend to have expertise chiefly in their home market; building a regional research function, in order to launch successful region-wide equity or debt funds, requires a great deal of time and investment. Homegrown Asian businesses don't immediately have brand recognition in regional or international markets either. So at every level – product development, staffing and distribution – there are clear hurdles a local manager must overcome in any international ambition.

Survey Findings

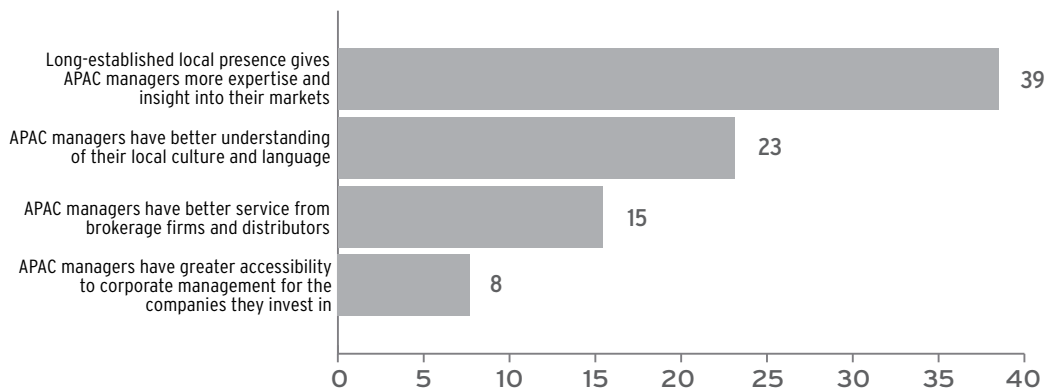
Asian managers were asked what they considered to be their main advantage over foreign competitors, and the results are in the following pages. Two thirds of local APAC managers believe that their length of relationships and track record in local markets give them an edge in investment management, with another 25% citing their superior cultural understanding. On the distribution side, 42% of Asian managers see their advantage in their commitment to local markets, with another 42% citing their ability to understand client investment behavior. One Asian manager summed up the argument quite succinctly: "Local managers know their markets better. We understand the culture, we have the relationships and we can get in to see the top management."

Exhibit 29: Asian Managers' Views on Their Greatest Advantage vis-à-vis International Managers for Investment Management in Asia, 2011



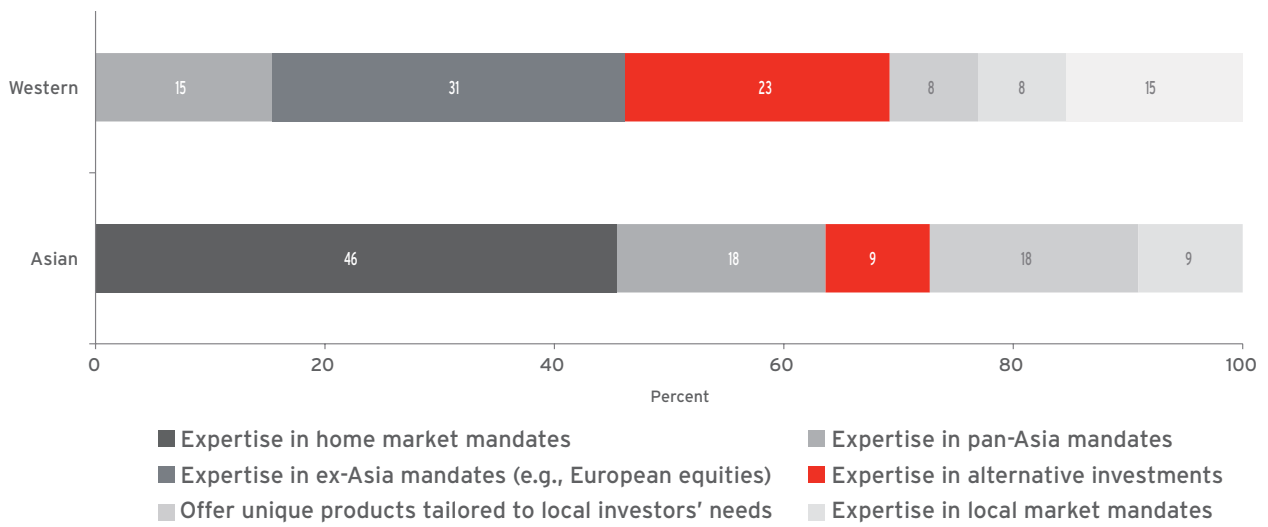
Sources: Citi SFS, Mirae Asset, Cerulli Associates

Exhibit 30: International Managers' Views on Their Greatest Challenge vis-à-vis Asian Managers for Investment Management in Asia, 2011



Sources: Citi SFS, Mirae Asset, Cerulli Associates

Exhibit 31: Survey Respondents' Views on Reasons Asian Investors Would Select Their Firms over Local Managers, 2011



Sources: Citi SFS, Mirae Asset, Cerulli Associates

The fact that many international managers have pulled out of Asia during difficult times is now being used against them. International managers concede that the biggest advantage Asia-Pacific-based managers have is their expertise in their home markets.

So why go with foreign managers? International managers see their main differentiators as expertise in mandates outside of Asia, and expertise in alternatives, whereas 73% of Asian managers think expertise in their home market or the regional in general wins the day. Comparatively, only 23% of international managers cite their expertise in local (e.g., Hong Kong) or regional (e.g., APAC equities) mandates as a differentiator; yet as seen in Exhibit 22, even Western managers concede

that Asian equities and fixed income will be very much in demand. Thus, it is fair to question whether or not Western players are bringing the right tools to the local market – especially for the retail segment, where expertise in alternatives is less applicable.

Does this mean that local players will dominate in Asia? Declaring a victor in the competition between local and Western managers is complicated by blurring lines between the two. Having previously overloaded with expats, today's Western entrants are increasingly hiring from the region and delegating decision-making locally – after having spent years researching target markets before taking the plunge.





Chapter 4: Conclusion & Prognosis

Conclusion & Prognosis

Key Findings

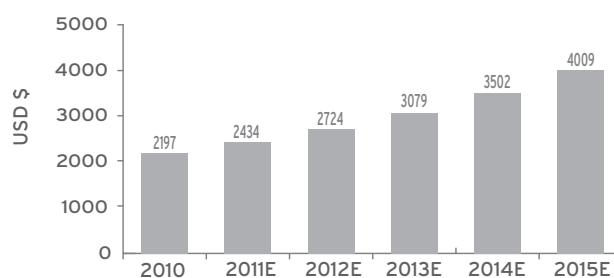
- **Cerulli expects an increasing pace of development in Asia ex-Japan, with assets under management, reaching US\$4 trillion by 2015, a near doubling from 2010. China is likely to be the principal engine of this growth, while Korea will continue to be a considerable force.**
- **Nobody knows how long it will take for the RMB to move to full convertibility, but the steps that have been taken so far have the whole financial services industry abuzz. There's much more to come: Mini-QFII, for example, could transform the power and influence of Chinese domestic asset managers.**
- **ETFs do not yet account for significant assets under management in Asia compared to mutual funds, but they are beginning to capture the popular imagination. At the same time, since the Chinese onshore mutual fund market is likely to be the main engine of the region's growth, mutual funds will still be key to retail growth.**
- **Institutional clients are increasing in sophistication, but this is not all good for external managers. In contrast to the opening up of insurers, more and more pension and sovereign funds will start to look like Temasek or GIC, institutions that don't, generally, need outside help.**
- **There are certainly examples of investment platforms and independent financial advisors gaining traction in Asia, but compared to the power of the banks as distributors, it's not yet significant. Diminishing the power of the banks is a very long-term process.**
- **Competition between Asian and Western managers will play out globally, and not just locally. Western players will have their commitment to Asia tested, particularly if they are unable to provide the right vehicles and strategies. Nevertheless, Asian managers are not content to compete locally, and some are already making a foray into Western markets.**

So, where next for Asian asset management? Is it a given that, in the region that is expected to be the engine of global growth for the foreseeable future, the asset management industry will gain equivalent scale? The future is bright, but it's not automatic that the industry will grow in tandem with the pace of underlying economies.

The Market Will Double in Five Years

Cerulli expects an increasing pace of development in the Asia ex-Japan asset management industry's assets under management in ex-Japan Asia, reaching US\$4 trillion by 2015, a near doubling from 2010. China is likely to be the principal engine of this growth, both through onshore mutual funds and through increasing institutional development, while Korea is also going to be a considerable force – indeed, it already is – on both the retail and institutional side.

Exhibit 32: Asia ex-Japan Asset Management Industry Assets Under Management, 2010 - 2015E (US\$ billions)

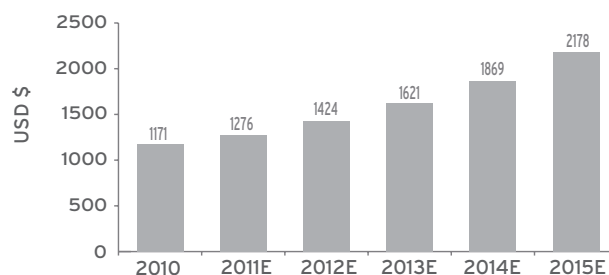


Source: Cerulli Associates

Mutual Funds Will Regain Their Vigor

Within that, mutual funds should grow at roughly the same pace. They represent just over half the market today and are projected to continue to do so by 2015. This is despite the fact that, as demonstrated in Chapters 1 and 2, the growth of mutual funds has been sluggish at best since the global financial crisis. Again, the growth of China's onshore mutual fund market is going to be the most vibrant part of this development; Cerulli expects a doubling of assets there over the next five years, which by 2015 will mean it accounts for more than one third of Asian mutual funds, and there are other respected research groups that expect a trebling instead. Cerulli also projects a near doubling in India, but because the starting point is much lower it will still only be the third-biggest market in Asia by 2015; above it will still be Korea, where there is every reason to expect strong and sustained growth.

Exhibit 33: Asia ex-Japan Mutual Fund Assets Under Management, 2010 - 2015E (US\$ billions)



Source: Cerulli Associates

Institutional Growth and Sophistication...

The closest thing to a certainty in our list of conclusions is that the institutional market in Asia will grow – but how will it grow? Clearly, sovereign wealth funds will increase dramatically in size. The long-established ones like GIC and Temasek will continue to reap the benefits of well-thought-out asset management strategies, building on an already large base; both CIC and KIC will be allocated more and more assets on top of the growth of their existing portfolios; and even new funds, from Timor-Leste to (in a few years from now) Papua New Guinea, on the back of its PNG-LNG development, will provide new engines. Pension funds, too, will be transformed in the next five years: It would be a surprise if NSSF in China did not double in the next five years, Korea's NPF is one of the largest such funds in the world already and is only going to grow and other established pension entities in Malaysia and Taiwan have no reason not to expect steady growth. On top of that, corporate pensions will gain greater traction, not just in established markets like Hong Kong but in those that have so far relied on state institutions. As assets grow, so too will the sophistication of these institutions in their asset allocation. This is clearly already happening, but the trend toward alternative asset classes, international equities, emerging markets and thematic investing will take greater root.

...Which Is Not All Good for External Managers

As these institutions grow in sophistication and ability, more and more of them will start to look like Temasek or GIC: institutions that don't, generally, need outside help, such is their internal capability. In contrast to the opening of the insurance market, the larger sovereign and pension funds will increasingly take core mandates in-house and external fund managers will increasingly

be expected to deliver highly specialized portfolio management skills – or, alternatively, very cheap passive ones that make it easier for institutions to outsource than to do it themselves.

Insurers Will Become A Leading Source of Assets

The recent changes in regulation in China around how insurers can invest their premia are a landmark in terms of the role that insurers in Asia will play as a source of institutional assets for fund managers. This huge market, with immense potential, will now be a prized target for local and institutional managers. In China, as well as other Asian markets, insurers have been the sleeping giants of the institutional asset management segment, and Cerulli expects to hear a lot more from this group in the next five years.

Offshore Funds Will Remain Constrained by Regulation

There is certainly going to be a strong and growing market for cross-border funds in Asia. But what's happening in Taiwan, with efforts to promote onshore funds and impede offshore ones, is illustrative. Few Asian markets outside the hub economies of Singapore and Hong Kong see any imperative to usher offshore funds in when they can instead be bolstering local industry. There's little obvious reason for that to change.

Internationalization of the RMB

Nobody knows how long it will take for the RMB to move to full convertibility, but the steps that have been taken so far have the whole financial services industry abuzz. From an asset management perspective, the early impact has been the development of new mutual funds around dim sum bonds – those launched in Hong Kong and denominated in offshore RMB. But there's much

more to come: Mini-QFII, when it comes, could transform the power and influence of Chinese domestic asset managers; and as the RMB becomes a more widely accessible and tradable currency, this will feed through into product demand, with investors increasingly seeking exposure not just to Chinese assets but the currency itself.

Asian Managers Are Going to Take On the World

Competition between Asian and Western managers will play out globally, and not just in their home markets. As Chinese fund managers begin to build on their Hong Kong beachheads, their access to domestic markets is going to be an exceptionally powerful marketing tool from which they will build other products and expertise. Expect Indian fund managers to become progressively bigger on a regional and world stage, too. Although Asian managers may have cultural and operational advantages in their home market, a few are already taking their investing and distribution acumen Westward. Sophisticated investors are likely to realize that if they are going to buy an Asian Equity fund, it only makes sense to consider an Asian fund manager.

ETFs Will Become A Force

ETFs remain a hot topic in asset management markets in the U.S. and Europe, and they're beginning to attract similar attention in Asia, too. ETFs do not yet account for significant assets under management compared to mutual funds, but they are beginning to capture the popular imagination. And perhaps more significantly, they will offer an avenue for the stranglehold of bank distribution to be undermined, since it will be brokers who are the chief agents for sale of ETFs.

Don't Hold Your Breath for Independent Financial Advice

There are certainly examples of investment platforms and independent financial advisors gaining traction in Asia, but compared to the power of the banks as distributors, it's not yet significant – and there's just no sign of this changing yet. Diminishing the power of the banks is a very long-term process, and since China is one of the places where the banks are strongest and is also going to be the biggest source of asset growth, the proportion of bank influence may get bigger still before it fades.

Appendix

About the Authors

Cerulli Associates is a Boston-headquartered independent asset management research firm with international offices in London and Singapore. The firm was established 20 years ago, and produces actionable research on asset management markets in over 45 countries around the world. For more information on Cerulli and the research we undertake, please visit www.cerulli.com.

About This Report

Cerulli Associates was commissioned by Citi SFS and Mirae Asset to produce a report on asset management trends in the Asian region. Like with other independently generated research, this report has been produced entirely on the basis of research undertaken by Cerulli's analysts. Information in this report has been obtained from public and non-confidential sources, proprietary interviews with asset managers, independent financial advisors, banks and other industry participants. Cerulli believes that the data herein is reliable and has made every reasonable effort to verify statistics presented. All data in this report is calculated in local currencies and U.S. dollars, as appropriate, which allows for comparative analysis. Exchange rates from **December 2010** have been used, unless otherwise stipulated.

About the Survey

Central to this report is a survey of some of the biggest and most prominent asset managers – both local and international – operating in Asia. In total, 30 of the most prominent Asia-based local and international managers took part in this survey, conducted over a six-week period in April and May 2011, representing 32% of assets under management in the region. The questions for this survey were prepared by report sponsors Citi SFS and Mirae Asset and the survey was administered via Cerulli's bespoke survey platform, www.cerullisurveys.com. The results were analyzed by Cerulli and the bulk of the findings are presented in this report.

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About Mirae Asset Financial Group

Mirae Asset is the leading independent financial services group in Asia with a unique culture of entrepreneurship, enthusiasm and innovation. While the group's core business is asset management, it also provides comprehensive financial services in the areas of wealth management and life insurance. Headquartered in Seoul, South Korea, the Group has a presence in Hong Kong, China, India, Vietnam, Taiwan, Brazil, the UK and the U.S.

Mirae Asset Global Investments is the asset management arm of Mirae Asset Financial group and is one of the world's largest investment managers in emerging market equities.¹ Based on the firm belief that the economic development of emerging markets is fundamental and sustainable, it has built extensive on-the-ground, research-driven investment capabilities centered on major emerging economies. With around 600 employees, including more than 190 dedicated investment professionals, the firm manages over US\$53 billion in assets globally.

(All figures are as of end of June 2011.)

¹One of the largest investors in emerging market equities amongst 54 asset management firms surveyed – Investing in Emerging Market Equities Survey, Investment & Pensions Europe (IPE), Jan., 2011



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