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Asian asset management moves into new markets and products: Industry survey reveals changing sentiments

In a recently released survey of asset management professionals conducted by Clifford Chance and AsianInvestor, three key themes emerged. Asian investors are diversifying away from equities, the marked decline of Europe as a source of assets and as an investment destination, and a more sober assessment of RMB investment opportunities.

Whilst the move away from equities to other asset classes can largely be attributed to the current market volatility and sentiment over the Eurozone crisis, the other two themes warrant a deeper look at why these trends have emerged and the implications for the asset management industry in Asia.

Key issues

- Asia-based professionals have little interest in Europe as a place for raising capital
- Despite an increasing number of RMB offshore products, investor uptake is limited
- Less than half of respondents plan to launch RMB products
- Debt capital markets, private equity funds, ETFs and managed accounts win over traditional equities
- Regulatory changes are at the forefront of people's minds

Europe in the cold

The survey results indicate that Asia-based professionals currently have little interest in Europe as a place for raising capital. Only five per cent of respondents chose Europe as the jurisdiction which most capital will be raised from, ahead of only Japan with three per cent and Singapore with two percent. This is in contrast with the United States which top the list with 28 per cent, Emerging Asia with 20 per cent and China with 18 per cent. Hong Kong follows closely with 16 per cent.

Several explanations are possible as to why Europe has fallen out of favour as a destination for fundraising. Is it due to the Eurozone crisis? Is it due the Alternative Investment Fund Managers Directive (AIFMD)? Is it due to problems with UCITS? In truth, it is probably a convergence of several factors.

The Eurozone crisis has led to uncertainty and volatility in the market with a credit crunch exacerbated by deleveraging and compliance with new regulatory capital requirements such as Basel III and Solvency 2. Faced with this scenario, funds may very well not even consider Europe for fundraising, finding the environment too hostile compared with other locations. The reality may be more nuanced though. While investors in Europe may be holding on to their cash at the moment due to the uncertainty in the European markets, this uncertainty could turn to an advantage for Asia and its more promising growth prospects as, ultimately, that cash will need to be invested to generate a return.

It's no surprise AIFMD is a looming spectre over the investment management industry. It presents a significant regulatory change which will affect the industry globally going beyond what even the US has done under Dodd-Frank. Although a strictly

European directive, certain provisions in the directive will have a direct impact on Asia Pacific based funds and managers who are looking to raise funds from investors in Europe. When AIFMD comes into force in July 2013, the new requirements and restrictions may not appear overly burdensome at first: there will be a need to have co-operation arrangements in place between the regulator of the alternative investment fund manager (AIFM) and the regulator in each EU jurisdiction in which the fund will be marketed, and the fund will be subject to certain disclosure requirements and investment restrictions. It is the second phase marked for 2015 when non-EU managers may have to become registered by the relevant EU regulator in order to continue their marketing to European investors that casts a much darker shadow. Although this should not be an immediate concern for an Asian manager raising a fund now, the discussions surrounding AIFMD have already had the effect of dissuading certain European institutional investors from investing in offshore funds, before the directive is even formally in force.

The attractiveness of UCITS has also been affected by the global financial crisis. Whereas the UCITS designation meant a facilitated access to Asian markets in the past, the discussions around the use of derivatives in UCITS structures, as well as more protective regulators generally, has made distribution of any but the most plain vanilla structures something of a headache.

The combination of these factors has meant that Europe now comes marked with a caution sign.

Waking up to the reality of RMB investment

China and its currency the Renminbi (RMB) have been at the forefront of economic news worldwide. While the convertibility of the RMB is still restricted, there have been a myriad of investment products launched onshore China as well as abroad which allow investors to invest in the currency and so participate in its anticipated appreciation. For example, in addition to the long-standing QFII (Qualified Foreign Institutional Investor) scheme, which allows foreign institutional investors to access the Chinese equity markets, foreign fund managers can establish fund vehicles in Mainland China raising money from both domestic and foreign investors, or establish RMB share classes in offshore fund vehicles.

For the investment community, the launch of the RQFII (Renminbi Qualified Foreign Institutional Investor) scheme last year generated considerable excitement. The RQFII scheme allows foreign offshore funds (in practice, retail funds authorised in Hong Kong and managed by Hong Kong subsidiaries of fund management companies and securities companies incorporated in Mainland China) to raise RMB funds offshore and invest those funds without conversion directly in Chinese bonds and equity securities. However, market take-up has been disappointing.

64 per cent of respondents in our survey indicated they had no immediate plans to launch RMB-denominated products, and 46 per cent saying they have no intention to do so.

On the face of it, it may seem somewhat surprising that following the continued regulatory relaxation by Mainland China of the QFII and RQFII schemes, there has not been more interest by the investment community. The reality is that the regulatory relaxations happening now, regardless of whether this is part of China's greater plan to open up to foreign investment or as economic stimulus, the changes are having minimal impact on a market that is extremely risk-averse, with a flight away from equities towards safer and less volatile assets. Yes, the quotas have increased for foreign investors to buy Mainland Chinese shares and bonds but there is less demand due to the current market downturn, limiting returns.

Move to debt and credit

Perhaps less of a surprise is the trend towards diversification from equities which we observed compared to the past few years: debt capital markets, private equity funds, ETFs and managed accounts have become more popular at the expense of equity capital markets, according to the survey results. Equities still remain the top asset class for global investors at 41 per cent although with a steep decline from 65 per cent a year earlier. So although the popularity of equities is waning, they are still the most sought after asset class by the industry.

So what now?

Sentiment across the industry is cautious. The move away from equity capital markets clearly signals that. Regulatory changes are also at the forefront of people's minds with FATCA, Basel III/Solvency 2 and the Volcker rule taking centre stage with 63 per cent of respondents citing these regulations as the most likely to impact the investment management industry over the next 12 – 18 months. There is clearly much more awareness of the impact of regulatory change outside Asia on Asian based managers than there was a year ago.

The mixture of economic uncertainty over the continuing Eurozone crisis with the impact of regulatory reforms are set to slow down the investment management industry globally.

Governments need to look at balancing the need to introduce regulations to protect investors with providing sufficient freedom for the investment fund industry to expand. Nobody's interests will be served if investment comes to a stop due to a combination of deleveraging, credit contraction and stringent restrictions on the offering of investment products.

The Eurozone crisis is a bumpy road. Rather than closing off a lane now to do regulatory roadworks, perhaps it is time to open up the emergency lane to let investments flow easier in the short-term?

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