



**Asian Funds:**  
**Outlook for Asian Markets and SRI**

**ASrIA Brief 002**

**By Melissa Brown, Feb 2005**

Gauging Asian markets is never easy. This is particularly true in the cautiously regulated and still immature market for Asian managed fund products. While this was the general message of speakers at the Investment Company Institute's recent conference in Hong Kong, there were clear signs of interest in specialty products including SRI funds. In addition, funds which make it possible for Asian investors to tap into global themes and which have more innovative product structures continue to gain market share.

The conference, sponsored by the US-based trade association for the mutual fund industry on January 11th and 12th, provided an unusually comprehensive health check for the managed funds industry in Asia and underscored a range of competitive challenges which have important implications for the SRI community. Four key trends appear certain to shape opportunities for new fund offerings in Asia for the coming year:

- Structurally risk averse retirees and workers saving for retirement remain the focus for most new products despite significant gaps in the equity product risk spectrum;
- Banks are beginning to dominate fund distribution, creating new distribution channels for independent fund providers in some markets and heightening the risk of conflicts with in-house products in others;
- The most consistent theme mentioned at the conference was the pressing need for more and better investor education;
- There are signs of product innovation as well as some regulatory fixes which could improve the environment for new equity products.



While Asian markets in general tend to be higher risk than their developed market counterparts, the most striking feature of the market for new funds is the predominance of variable annuity products, bond funds, and products with either regular distributions or guaranteed principle provisions. There are pockets of interest in new equity products, including SRI which has been successful in attracting new investors. Nonetheless, high market volatility, a rapidly ageing investor base, and a history of limited products have resulted in a skeptical marketplace which focuses primarily on security, not diversification.

### **Aging Investors Running from Risk**

What are the key drivers for this culture of caution? Starting first with age, speakers touching on the Japanese market painted a very clear picture of the dominant trends. Most prominent is the fact that the asset mix in Japan is heavily skewed toward cash with only 8% of managed assets in equity products. This conservative asset allocation is a reflection of the concentration of assets held by aging investors, with investors over the age of 60 holding 46% of all managed assets. Indeed, the cash flow requirements of Japanese investors have resulted in growth for global bond and structured equity fund offerings which provide monthly payouts.

Variable annuities have also seen very rapid growth according to market participants who cited survey data from Japan pegging investor preferences as being 54% for security, 26% for liquidity, and 15% for profitability. In response, variable annuity providers have been revamping their products to increase guaranteed structures and to focus exclusively on customers over 50.

While trends elsewhere in Asia are somewhat less stark, trends evident in Japan are echoed in other markets. In Korea, regular savings plans (RSPs) are beginning to drive asset growth in annuity-style products. At the same time, there have been some notably successful launches with high yield balanced equity funds attracting significant assets. Nonetheless, the Korean market remains difficult for untested fund managers. Nearly half all assets under management are in funds with an investment history of less than one year and fees have collapsed to 54 basis points for equity funds.

Elsewhere in the region, much of the focus remains on the steady shift away from defined benefit to defined contribution products and the efforts of various governments to engineer new, low cost structures for pension investment. Australia continues to lead the marketplace with the planned mid-year move to fund choice which is expected to tilt the business in the direction of retail fund distribution channels. In Hong Kong, Mandatory Provident Fund (MPF) fund performance has been hurt by the requirement that 30% of fund balances be invested in local currency assets — a limitation which reflects region-wide caution about foreign investment of pension assets. [[Dec. 31, 2004 MFP fund statement](#)] Singapore's proposed structure for privately managed pension funds, outside of the Central Provident Fund (CPF), is still being reviewed by the government and is regarded as an interesting, if untested, blueprint for current thinking about models for creating a low cost platform for pension investment.



## **Bank Distribution — The Promise of a Big, But Immature Channel**

A number of the ICI panels devoted time to the emergence of banks as the fastest growing distribution channel for funds. While most speakers were quick to emphasize the virtue of having access to larger pools of retail assets, there is obviously concern about immature sales practices and competition from in-house products — trends which could undermine market acceptance of managed funds products.

In Japan the focus is on the upcoming privatization of the Post Office Bank. The consensus is that the Post Bank will be a major player in fund distribution, which should be a boon to a number of independent and foreign fund providers. Catalysts are expected to be a gradual shift toward defined contribution products which will drive a move toward open architecture strategies and further pursuit of “best product” strategies. In the meantime, there is a hope that the banks, which have gained a 34% market share in distribution in only five years, will lend momentum to efforts to bring more first-time investors into the managed funds realm.

In Korea, the retail-oriented banks, including new acquirers Citibank (Koram) and Standard Chartered (Korea First Bank) are expected to play a major role in expanding the bank distribution channel. Kookmin Bank through its tie up with ING is also gearing up its operations. In Korea, market players see the foreign entrants as a positive force for change, bringing higher standards and less commoditized products, backed by more sophisticated marketing strategies.

## **Where are the Gaps in Market Infrastructure?**

Any event which brings together both market participants and regulators promises a delicate dance around controversial issues. A number of panelists voiced concerns about the generally low level of investment education across the region and the potential challenges posed by more investor choice and growing reliance on retail-oriented distribution. While this is certainly not a uniquely Asian problem — witness the poor investment track record of US investors in their 401(k) retirement accounts — it is a problem in Asian markets where investors shun equity products despite the need to diversify.

Again, the Australian market will be one to watch as the market ramps up for fund choice. The SRI community offers an interesting example of potential trends with the Ethical Investment Association's 2004 [SRI Benchmarking Survey](#) noting that, “Assets of SRI managed funds in Australia grew by 41% between June 2003 and June 2004 (to AUS\$21.5 billion) more than twice as fast as the overall Australian retail and wholesale investment market (which grew 18% over that period). Also the introduction by the Australian Securities and Investments Commission (ASIC) of new investment fund disclosure standards which require managers to describe their investment process in regular disclosures and the Ethical Investment Association just completing a project to create a recognition symbol for SRI funds.



Elsewhere in the region, it is possible that governments may play a more active role in pushing for educational programs. In Taiwan, the government has been looking at strategies for developing curriculum material for high school students.

A second set of issues, dear to fund managers and analysts, is the question of disclosure standards in Asian markets. One representative of a large US-based fund manager was quick to make the point that global investors no longer have the option of simply overlooking regions or markets which may have poor standards. With corporate and market trends in emerging market increasingly shaping global business strategies, it is no longer possible to have a complete understanding of US equities without understanding European and emerging markets. Not surprisingly, this raises the risk associated with the poor disclosure standards and uneven enforcement evident in some Asian markets.

Another theme to emerge, with strong support from ASRIA's presentation, was the impact of numerous quasi-privatizations on Asian markets. Indeed, large chunks of listed market capitalization in Asia consist of government-controlled companies, many of which lack a commitment to independent regulation or candid disclosure. This has heightened the impact of governance risks and has negative implications for long-term equity returns if markets become dominated by static government entities which cannot re-orient toward longer term economic opportunities.

### **Product Innovation**

China and Taiwan, two markets which have faced structural challenges, have seen recent new product launches which could help stabilize markets. The introduction of exchange traded funds (ETFs) for non-tradable PRC shares has the potential to create an efficient passive vehicle for reducing the overhang of government-held shares in listed companies. At the same time, with the launch of a first stripped bond issue, there are signs that market players are creating instruments which may help resolve the net asset value (NAV) problems for Taiwan bond funds by offering products with greater liquidity.

In markets where investors struggle to find products with the right levels of risk and diversification, structured "life cycle" funds may hold some attraction. These funds, like the [Growth Path funds](#) offered by UOB Asset Management, provide a gradual shift in asset allocation as the investor ages and risk requirements change. Given the concerns expressed about gaps in investor education, products which offer a new strategy for meeting investor needs are well worth watching.

Although much of the discussion at the conference focused on challenges for fund providers, there are some noteworthy positive trends. It is clear that conventional products have become commoditized, leaving little room for value addition. There are signs of innovation, however, especially with products which have the ability to draw new investors or which offer a new approach to risk diversification. In Japan, the high growth products include funds with periodic payouts, real estate investment trusts (REITs), China funds, SRI funds, and a limited range of absolute return vehicles including funds of hedge funds and global balanced funds.



While REITs and periodic payout funds cater to demand from older investors, SRI funds in Japan have been notable for attracting a high mix of younger, female first-time investors in equity funds. For this demographic, SRI funds are seen as a prudent investment which offers equity exposure, and a more disciplined management style, as well as appealing to a strongly rooted environmental awareness among this group. In ASrIA's 2004 survey of Hong Kong investors, higher income, educated women stood out for their potential interest in SRI products. With more Asian SRI funds in the pipeline in 2005, we expect to see more data on SRI fund launches which should provide fund providers with a clearer picture of the demand for differentiated equity funds.

### **The Association for Sustainable & Responsible Investment in Asia**

[www.asria.org](http://www.asria.org)

ASrIA is a not for profit, membership association dedicated to promoting corporate responsibility and sustainable investment practice in the Asia Pacific region. As an association, ASrIA acts for and on behalf of its members. ASrIA's members include investment institutions managing over US\$2 trillion in assets, however membership is open to any organisations which have an interest in promoting sustainable investment practice.

ASrIA has taken a leadership role in promoting sustainable investment in Asia since our founding in 2001. In order to raise awareness about SRI, ASrIA has run conferences, seminars and workshops, and published wide-ranging research on SRI issues. ASrIA has also created a very wide network of people and organizations committed to developing SRI in Asia. ASrIA's website, [www.asria.org](http://www.asria.org), is the primary resource for SRI in Asia, attracting over 2,500 page views per day and over 5,000 subscribers to our regular [e-bulletin](#).