Sovereign wealth funds are key focus

Business and financial hubs re-align strategies after the crisis

By Tan Lee Hock

Sovereign wealth funds in the Gulf Cooperation Council (GCC) are raising their exposure to direct investments globally; SWFs such as the Qatar Investment Authority (QIA) and the Kuwait Investment Authority (KIA), for example, have been actively investing directly as have other large funds from the GCC. Both the QIA and KIA were in the news in Asia last month, with reports of them taking substantial stakes in the Agricultural Bank of China's public flotation in Hong Kong and Shanghai. The QIA's stake was reported to be worth about US$2.8 billion, making the fund the largest single investor in the exercise.

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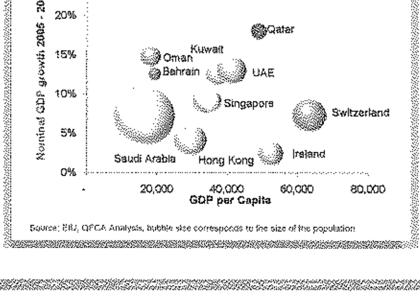
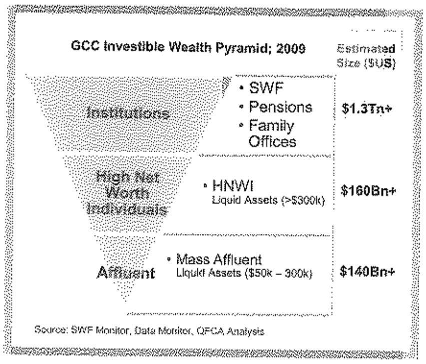
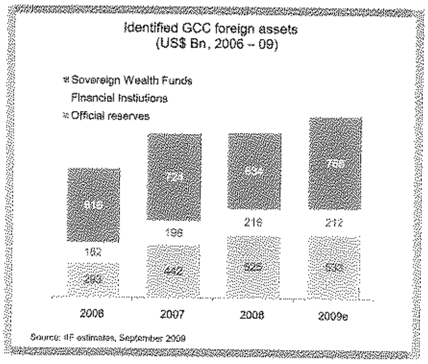


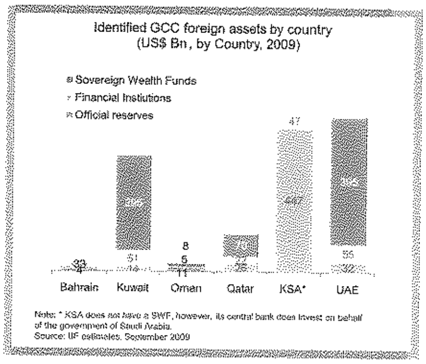
Source: EIU, QFCA Analysis, bubble size corresponds to the size of the population

In the last few years, a brace of global fund houses have been establishing a presence right across the region. "The GCC is a key region for us to address and we are putting resources on the ground in Abu Dhabi," says Craig Bingham, the chief executive officer of Aviva Investors. Mr. Bingham, like his colleagues, sees institutional investors from the region widening their investment base.

Typically, the Abu Dhabi Investment Authority (ADIA), established in 1976, has been broadening its massive portfolio, reportedly with assets of more than US$600 billion. Asset allocation data published on its website show that the fund now invests in developed and emerging markets, including small cap equity, global bonds, credit, alternatives, real estate, private equity, and infrastructure which was included in its portfolio in 2007. Interestingly, in outsourcing to external equity managers, the fund has more than 100 such active and passive man-







dates, according to information on its website.

It is not just the activities of ADIA that are closely monitored by global fund managers who are eager for a piece of the action; the region's SWFs as well as pension and other funds are being closely tracked.

In the last couple of years, a handful of asset management firms set up marketing and client facing offices in Dubai with firms such as ING, Prudential and Deutsche hoping to gather some of these assets; it is not clear how successful these initiatives have been to date though.

Collectively, one estimate of the size of the institutional fund market in the GCC is about US$1.3 trillion, made up of the assets of SWFs, pension funds and family offices. If the assets of high net worth individuals and the mass affluent are included in the figure, the total investible pool of assets is estimated to be more than US$1.6 trillion, according to some estimates.

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Challenging times

However, the retail market value proposition is a different matter altogether given the thin capital markets that characterise the region with the exception perhaps of the regime in Saudi Arabia. Onshore fund raising activities in the retail space, as a result, are modest undertakings and have been subdued post the global financial crisis. Dubai's financial woes, too, have been sobering for the region with the collapse of the real estate market after an unprecedented construction boom. "It has been extremely challenging to raise retail assets post crisis so expectations have been lowered dramatically in the last year or so," says a Dubai-based banker.

Whilst stock market capitalisation in the GCC grew by an impressive five-fold between 2003 and 2008 and a doubling of listed stocks over the same period, those dizzy days are now a distant memory. Stock market capitalisation topped US$1 trillion in the GCC at the end of 2008 and after the crisis, market capitalisation shrivelled by 38% to about US$625 billion in 2009.

Saudi Arabia remains the largest exchange in the region with some 46% of the total market capitalisation in the region followed by Kuwait with a market capitalisation of US$189 billion at end 2009 and Qatar with US$111 billion. But investor access to the Saudi market by foreign investors is the most restrictive among the GCC states although planned reforms are expected later this year. Foreign investments in the Saudi market totalled only about US$4 billion as of February this year. The planned launch of an exchange traded fund in the local market, approved in March, may also help to attract more such listings and raise foreign investors.

The onshore retail fund market in the GCC, to be sure, is small relative to the size of their GDPs. Funds that are domiciled in the GCC reported assets under management of just over US$26 billion in February of this year with funds in Saudi Arabia and Kuwait accounting for the lion's share (92%) of the total, according to estimates provided by investment bank Markaz and Zawya, an online publisher.

There were some 122 funds in Saudi Arabia with 58 funds in Kuwait. The total assets under management of funds invested in MENA and the GCC, on the other hand, were estimated to be about US$35 billion. Funds investing in the GCC markets accounted for about US$26.6 billion with the balance of US$8.5 billion invested in MENA.

A number of global houses have meanwhile been launching GCC or MENA focused funds for

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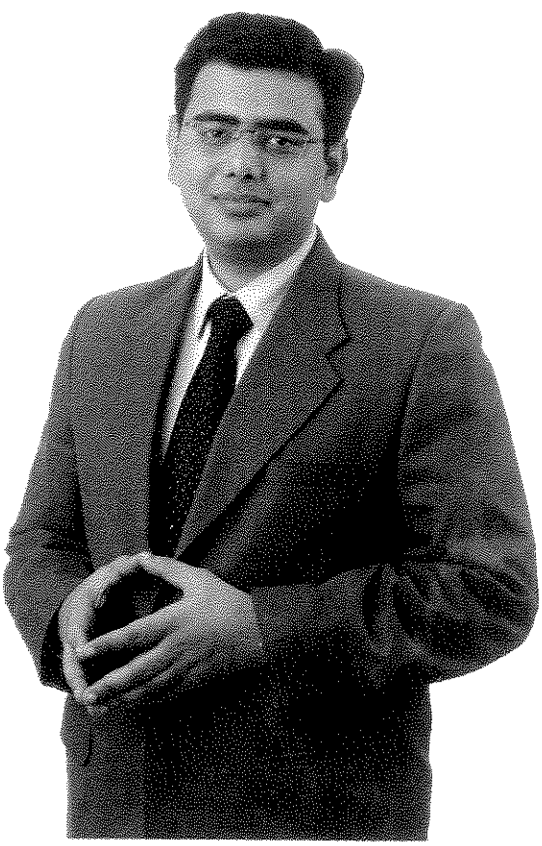
QFC aims to attract asset managers

Scope for Asian houses to tap opportunities

When it comes to attracting global fund managers to set up shop in the Qatar Financial Centre (QFC), it is the quality that counts, says Shashank Srivastava, the acting Chief Executive Officer of the Qatar Financial Centre Authority (QFC Authority). "The number of licensees may provide an indicator of our progress in establishing a financial centre but that is really a red herring. The key for us to have a sustainable asset management industry is to attract sound and credible asset management firms and institutions," he explains. An important indicator, says Mr. Srivastava, is the amount of assets under management that will be undertaken within the QFC in the future rather than the number of institutions in place.



Shashank Srivastava

"To us, this is how we will chart our progress as we embark on our next stage of our development," he explains.

The QFC Authority is now implementing a five-year plan as part of a long-term strategy to develop financial services. Asset management is one of the key sectors that the QFC Authority is actively promoting as the country moves to diversify its economic base; there are compelling reasons to be optimistic for the asset management industry in Qatar and indeed, within the six states that make up the Gulf Co-operation Council (GCC).

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At the macro level, GCC economies are indeed robust, driven by re-investments of hydrocarbon revenues. Collectively, GCC's real GDP output was estimated to be about US$930 billion last year, making the region to be among the top 20 in the world. Their economies are projected to expand by 4.8% annually between 2009 and 2013, with Qatar expected to register the highest growth rates of about 11% a year.

Savings rates, moreover, are high with an average rate of 38% across the GCC region compared to a world average of 21% based on data from the Economist Intelligence Unit. Per capita GDP on the other hand in the GCC is the highest in the emerging markets with Qatar leading the pack.

Significantly, accumulated institutional assets in the GCC are estimated to be in excess of US$1.3 trillion, comprising the assets of sovereign wealth funds, pensions and family offices, a number of surveys undertaken last year show. Another US$300 billion of assets are in the hands of wealthy individuals. As a proportion of the total assets of sovereign wealth funds (SWFs) in the world, SWFs in the Middle-East now account for about 46% of the total compared to the 33% share held by SWFs in Asia.

These huge pools of assets make the GCC an attractive region from which to raise capital as well as to manage these assets onshore. A report by the Monitor Group indicate that post the global financial crisis, SWFs in the Middle-East are re-aligning their global portfolios to invest in their domestic as well as emerging markets.

It is against this backdrop that the QFC Authority is now promoting asset management. When the agency was established nearly five years ago, the priority then was to create all the necessary mechanisms in place, including infrastructure, the regulatory, judicial and legal environment, tax, and administrative functions that were needed to support the operation of a financial regime. "In a sense, we created two systems that work in parallel, one within the QFC and the other which is the State of Qatar," explains Mr. Srivastava. Most of the work related to the QFC's establishment is now complete and the regime is now moving forward to its next phase of growth.

In attracting global fund managers to the QFC, he notes that the centre looked at various models being applied across the world. "We will embrace some of these practices that are best suited for us and certainly, this will include aspects of the front, mid and back office activities of fund managers that can be undertaken onshore," he adds. For example, for global fund managers investing in the GCC and MENA, it would make sense to have a local presence in the region to undertake research and portfolio management activities.

In the past few years, a brace of global fund managers have launched mutual funds that invest in the GCC and MENA; total assets under management of these funds are currently just over US$35 billion, according to some estimates. Of this amount, about a quarter (US$23 billion) is invested in the markets that make up the Middle East and North Africa (MENA) and the balance in the GCC. By asset class, equities account for about US$12 billion of the total.

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"We want to encourage asset managers to come to the QFC to do this and I think with our platform, we are an attractive location from which to operate," proclaims Mr. Srivastava.

There are positive signs ahead. Boosted by steady economic growth, the region's stock markets too are expected to expand in the years ahead, increasing the breadth and scope of their activities. For the stock markets in the GCC, market capitalization between 2002 and 2009 rose by more than four-fold to US$625 billion; no less, the number of listed companies has nearly doubled from 353 firms to more than 730 over the same seven year period.

Within the QFC, four categories of licences are issued to prospective participants. Currently, 120 licenses have so far been issued to a range of institutions and companies of which 106 are active in the regime; among their ranks, there are now about half a dozen asset managers operating in the QFC.

Mr. Srivastava is eyeing Asia to attract the region's domestic fund managers to expand to the QFC. "I think with the growing linkages between Qatar and Asian economies, there is good scope for some Asian houses to play a meaningful role in capturing and managing the growing capital flows," he adds.

In terms of the profile of fund managers, Mr. Srivastava says the QFC is keen to attract traditional, long only managers as well as non-traditional asset managers, including firms from the alternatives sector. Islamic asset managers are also targeted. "We do not and cannot really specify the types of asset managers that should be encouraged nor can we indicate what products they should manage within the QFC. These are commercial and market considerations."

Post the global financial crisis, regulators the world over are moving to review their existing arrangements with a view to strengthening their regimes. The regulator in Qatar, the QFC Regulatory Authority, too, is moving in this direction.

This year, the QFC Regulatory Authority published a consultation paper to develop the asset management industry. The focus of the exercise is to expand the retail market in terms of the operation and distribution of onshore and offshore domiciled mutual funds or collective investment funds. The QFC Regulatory Authority is also seeking views to allow these funds to outsource parts of their administrative functions and activities to independent third parties and custodians.

In doing so, the QFC is seeking to embrace global best practices for its fledgling funds sector. ■

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retail investors in the last couple of years. One of them is the Franklin Mena Fund that was launched in November 2008 and sub-advised by Dubai-based Algebra Capital, a firm now 40% owned by Franklin Templeton Investments. As of end June 2010, the fund reported assets of US$95 million.

In late March this year, Barings launched its delayed MENA product. The fund attracted lukewarm response and as of end May, the Dublin-domiciled fund reported assets under management of less than US$13 million. Other planned fund offerings investing in the region may well be delayed, according to a banker in Dubai.

Opening up

But starting from a relatively low base, the prospects for growth in the asset management industry do look promising given the undeniable attractions of the GCC economies as they prime themselves up for the next stage of growth.

According to a study by Cerulli Associates, onshore assets under management in the Middle East are projected to increase from about US$57 billion in 2007 to more than US$100 billion in 2012.

In a bid to capture some of these activities onshore, a number of states have been working to boost their regional ambitions as business and financial hubs.

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Bahrain, Dubai and Qatar have put in place regulatory frameworks as well as enhancing their legal and business regimes.

But following the global financial crisis and the market collapse in Dubai last November, the Emirates has been put under the shade as companies and financial institutions have started to downsize their operations or in some cases terminated their activities.

Asset managers have not been spared either as a number of them who opened in Dubai have since withdrawn and are reviewing their scope of activities in the GCC. The downsizing has affected not just fund managers but also other service providers such as lawyers, administrators and accountants.

With the loss of revenues, some centres have taken the axe to reduce head count. Troubles in the Dubai International Financial Centre (DIFC) have since led to staff redundancies, according to a number of media reports. At one time, the DIFC had about 400 employees. The Qatar Financial Centre (QFC) too has revised its strategy and has re-focused its efforts on the insurance and asset management sectors.

To boost the asset management regime, the QFC is moving to review the existing framework for the distribution of retail funds, amongst other areas. According to Michael Ryan, a deputy chief executive officer and a managing director of policy and enforcement at the Qatar Financial Centre Regulatory Authority (QFCRA), the current rules permit authorised firms to market and sell foreign funds to qualified investors subject to certain disclosure requirements.

This March, the QFCRA published a consultation paper seeking views on a proposal to allow the sale of foreign funds to retail investors as well as qualified investors. The consultation paper also sought views on allowing authorised firms to operate and manage foreign funds and to establish a regime for QFC registered retail funds. The agency also sought views on a proposal to allow custodians of a fund to perform certain administrative functions, including calculating a fund's net asset value and effecting record keeping activities. The proposals may go into effect later this year.