The evolution of India's asset management industry

India's asset management industry has seen huge growth over recent years, and its expansion is only going to pick up pace with impetus from the growth of alternative investment funds, pensions products, the simplification of fee structures, and education, commentators believe.

India's asset management industry has enjoyed a huge boom, with growth of 1,412 per cent over the past 15 years, and there are no signs of it slowing down yet.

According to moneycontrol.com, Indian fund managers had AUM of INR11.05 trillion (US$177.3 billion) as of end-December 2014, an increase of 4.27% from the end of the previous quarter. The new year saw another surge in AUM to about INR12 trillion at end-February, according to businessworld.in.

"A new group of investors are now coming through."

ANDREW HOLLAND
Ambit

A large chunk of this growth has been driven by the strong performance of local equity markets, with the Sensex surging about 35% in 2014, but there are some players who have managed to buck that trend and been able to produce genuine alpha.

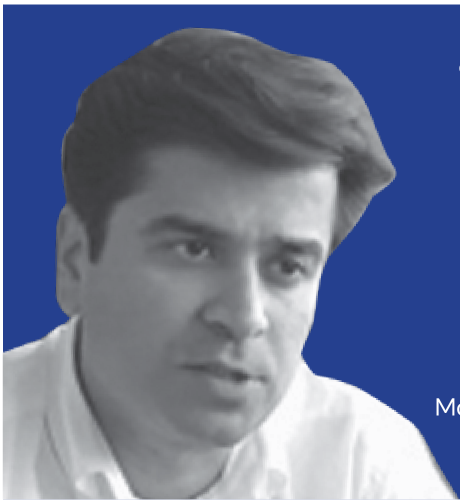
Despite the opportunity such huge growth represents, an increasing number of foreign asset managers are leaving India as they believe they cannot compete with local players.

There have been numerous deals in recent years. In September 2014, Pine-Bridge MF said it was selling its funds to Kotak Mahindra Asset Management, and earlier the same year ING Investment management sold its assets to Birla Sun Life Mutual Funds.

And now there are at least another three other foreign asset managers looking to exit the country, according to the-hindubusinessline.com.

HIGH CONCENTRATION, STRONG PERFORMANCE

It is a highly concentrated market, at least at the top end, with moneycontrol.com figures suggesting that the top 10



“The large retail brands have developed great investment capability over the years.”

AASHISH SOMAIYAA
Motilal Oswal Asset Management

fund managers have about 80% of industry AUM.

There are some clearly dominant players, such as HDFC Mutual Fund, which has INR1.41 trillion in AUM, and ICICI Prudential Mutual Fund, which has INR1.36 trillion. The biggest foreign players are Franklin Templeton Mutual Fund, which has AUM of INR636 billion, and DSP Blackrock with INR375 billion.

“The large retail brands in India, which all have asset management businesses, have done a remarkable job in the last 20 years,” according to Aashish Somaiyaa, chief executive officer at Motilal Oswal Asset Management. “They are most likely to mention their wide distribution [capability], but over the years they have also developed this great investment capacity.”

Progress has been made across the board, according to businessworld.in, with small/mid-cap funds logging gains of 70% over the past year and “almost all other fund categories” posting returns of 40% to 60%.

Compared to foreign asset managers who have tried, and failed, to set up shop in India, foreign asset managers and institutions are much less gun-shy about prospects for the country.

Pensions & Investments has reported that Netherlands-based asset manager Robeco is overweight India in all of its fundamental emerging market strategies, which have about US$20 billion in AUM. The same publication reported that the Canada Pension Plan Investment Board has invested C$1.4 billion (US$1.1 billion) in Indian companies since 2010 alone.

Many commentators believe that foreigners, and non-resident Indians (NRI) will increasingly look to their home country as an investment opportunity. “Funds are coming back and will continue to return to India,” says Gokul Das, the managing director and chief executive officer at Mumbai-based Warmond Trustees & Executors.

“There were some questions in the past about the political landscape and the economy, but these have been quelled.”

“Investment in India is very cyclical” adds Jaideep Hansraj, head - wealth management and priority banking at Kotak Mahindra Bank. “Now [the market looks good and everybody wants a piece of the cake. I don’t see anything wrong with this, as individual money will tend to be opportunistic.”

NEW ASSET CLASSES

The financial budget proposal by Arun Jaitley, India’s finance minister, that foreign investors be allowed to invest in alternative investment funds (AIFs) could be another boon for the industry.

AIFs were introduced to India in mid-2012. As of end-2014, 123 of the funds have sprung up, according to official figures from the Securities & Exchange Board of India (SEBI).

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“REITs could access a liquid market representing one third of all wealth assets in India.”

SHIV GUPTA
RBS

These funds have raised INR2.05 billion in commitments, which may not sound much compared to the boom in mutual funds, but growth is even faster in this segment than it is in mutual funds, at 17% in the last quarter of 2014.

Most of AIFs for sale in India are Category I funds, which invest in start-ups, early stage ventures or social companies, or Category II funds, which are general vehicles, such as private equity or debt investments. Category III funds are those, including long-short investments, which target short-term returns and can be highly leveraged. This last category has been the least popular, and currently represents only 11.4% of the AIFs registered with SEBI.

Many commentators believe India is not ready for hedged products, at least until there is better segmentation of investors. One senior figure at a trust company believes India should introduce categories of investors along the lines of Singapore’s Accredited Investors and Hong Kong’s Professional Investors. “We are always worried that the retail investor should not be taken for a ride,” she says. “Why would you allow them to invest in derivatives when they don’t know a thing about them? That said, there is no harm in allowing investors who want this kind of exposure to have it, and hopefully it will lead to development of the industry.”

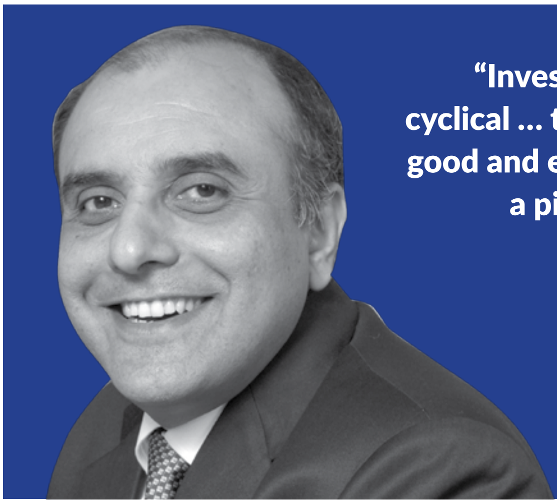
Some providers are doing just that, not least Ambit Investment Advisors, whose long-short Indian equity fund, Ambit Alpha, has grown to INR2 billion (US$32 million) since launch, according to business-standard.com. “People had a bad experience in 2007,” explains Andrew Holland, Ambit’s CEO. “But a new group of investors are now coming through and hopefully they are being told about risks.”

Younger Indians, particularly those who have been educated or lived overseas,

TOP 10 FUND MANAGERS IN INDIA

Mutual Funds	September 2014	December 2014	Change	% Change
HDFC Mutual Fund Buy Now	141,481	150,468	8,987	6.35
ICICI Prudential Mutual Fund	127,664	136,763	9,100	7.13
Reliance Mutual Fund	122,068	126,069	4,001	3.28
Birla Sun Life Mutual Fund	102,616	107,968	5,352	5.22
UTI Mutual Fund	83,250	87,390	4,140	4.97
SBI Mutual Fund	72,850	72,141	8,032	4.77
Franklin Templeton Mutual Fund	55,611	63,643	8,032	14.44
IDFC Mutual Fund	45,738	47,920	2,182	4.77
Kotak Mahindra Mutual Fund	37,445	38,796	1,351	3.61
DSP BlackRock Mutual Fund	37,483	37,532	49	0.13

Source: moneycontrol.com



> **"Investment in India is cyclical ... the market looks good and everybody wants a piece of the cake."**
>
> **JAIDEEP HANSRAJ**
> Kotak

are more willing to take a chance on alternative assets than their parents have been, commentators believe.

In other developments, the recent financial budget suggests there might soon be a surge in Real Estate Investment Trusts (REITs). Under the recent Financial Budget proposals, these funds will be able to pass through capital gains tax to unit holders.

"The creation of REITs potentially allows you to create a liquid market for an asset class which represents one-third of all wealth assets [in India], depending on which estimate you look at," says Shiv Gupta, managing director of private banking at RBS India. "Potentially this pool of assets will be overseen by professional managers."

The requirement that asset managers spent 2 basis points of AUM on investor education is going to help people understand these new asset classes. As things stand the requirement means INR2.4 billion of industry AUM will be dedicated to bringing Indian investors up to speed.

Commentators believe that investor education will need to be a constant feature of India's asset management landscape so that consumers come to understand the merits of different products. Smaller cities that have not yet been reached by the industry will prove challenging, but worthwhile.

A recent report published by PricewaterhouseCoopers reveals that asset management companies have gone to sizeable efforts to educate local investors. The consultancy noted that between May 2010 and May 2013, 36 asset management companies conducted 31,283 programmes in 485 cities, with 944,772 participants.

Another big boost to the sector could come from the government's intention to sell units of the Central Public Sector Enterprise (CPSE) exchange-traded fund, which was established to hold the assets of state-owned enterprises. Reports suggest that the government intends to generate INR43.4 billion from the sale of units this year, liquidity that could find its way into the hands of mutual fund managers.

Despite these clear prospects, not everything is rosy in the asset management industry.

On the downside, there appears to be little demand for mutual funds outside India's biggest 15 cities, at least according a study by SEBI, which notes that the distribution of advisers is "clearly skewed in favour" of the country's top 10% of regions by GDP. Notably, the bottom 50% of regions by GDP have only 4% of the country's IFAs despite representing 17% of the economy.

Also, there is a strong desire among fund managers to get involved in the pensions industry in India, but they are currently discouraged by the tax and regulatory environment from doing so. However, even in this area there are changes afoot.

In February this year, Reliance Capital Asset Management launched a mutual fund pension scheme, and there is talk that at least eight other fund managers are looking to follow suit.

There is also chatter about the introduction of a '401k-style' pension product to the Indian market, which will be called a mutual fund-linked retirement plan (MFLFP). Commentators believe that such a scheme could prove "the missing element" for India's asset management industry, and that the development of related "outcome-based" products could be a "game changer."

Although the expected announcement on this in the 2015 Financial Budget did not come to pass, it did mention there would be uniform tax treatment for pension plans and mutual-fund linked plans. The current opportunity for fund managers is in India's National

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ANURAG SETH
Quant Capital Advisers

Pension System (NPS). This is a good deal for savers – according to the new budget they can now contribute INR150,000 (up from INR100,000) a year tax free into the scheme, and there is a further tax deduction of INR50,000.

However, the opportunity for the asset management industry is less appealing.

The fund management fee under the NPS is a mere 1 bps and the distribution spread is only 25 bps. There is a clear need for pension products in India, and they are being encouraged as part of the country's plans for financial inclusion, but for now the opportunity for fund managers is a narrow one.

This has been recognised by Henant Contractor, chairman of the Pension Fund Regulatory and Development Authority, who was quoted in a *Times of India* report as saying that although fees on NPS funds would never be as high as they are on mutual fund sales, distributors "should be able to sell [NPS funds] with a slightly improved compensation structure."

Things are also changing on the pure product distribution front.

Some fund managers are dealing only with distribution platforms such as retail banks, broker-dealers, private banks and family offices, as they believe it's too difficult to try to capture a part of the distribution value chain themselves.

"The value chain at the moment is 250 basis points and it won't reduce sharply," says Somaiyaa at Motilal Oswal. "If we go very deep into distribution by building a huge B2B or B2C force our own need for part of that will be so high we will not be able to leave much on the table for our intermediaries.

"If the agents were to get hooked up to an aggregator they would get good service, but the asset managers lure the agents with good commissions and want them to work directly, completely ignoring good service for the end consumer," says Somaiyaa.

The introduction of a new MF Utility platform (mfuindia.com) has been a major change to the distribution model. Investors can access this using a common account number and there are currently 25 fund managers on the platform, including big names such as ICICI, Axis and Franklin Templeton.

The distribution landscape could be further streamlined by the cap of 100 bps on upfront commission recently proposed by the Association of Mutual Funds of India and taken up by SEBI, although *The Business Standard* reports that most fund managers want a 50b-basis-point limit so they can increase trail fees.

The move is in response to complaints to SEBI in previous years that high upfront fees, in some cases of as much as 6% to 8%, were encouraging mis-selling of new funds.

"Fees are coming down," says Anurag Seth, head of global wealth management at Quant Capital Advisors.

"The change is because instead of clients the focus has been on distributors, and you cannot keep on using the same methods to grow assets."

Costs will also come down as the industry starts to use technology to sell funds, commentators believe. In addition to the mutual fund utility, individual companies like ICICI and FundsIndia are proving online platforms.

FundsIndia is at the vanguard of this trend. It enables potential investors to set a quick risk profile and then suggests what proportion of their savings should be invested in a particular type of fund, be that large cap, diversified equity or income products.

Fund managers themselves are starting to take heed and sell process rather than performance, concludes Somaiyaa. "Our sales team has strict instructions that they are not allowed to lead any conversation with numbers and product. They are only supposed to lead with our philosophy and process." ■