December 2012

The Guide to

WEALTH MANAGEMENT IN INDIA 2012

hubbis

FOREWORD

On behalf of Religare Macquarie Private Wealth, I am proud to be part of this publication in association with Hubbis for the second-year running.

Many things have changed since I penned my message for the last publication in 2011. We continue to be faced with unprecedented market conditions. The economic climate in certain regions remains precarious at best.

This crisis will long be remembered as the one single most important event that acted as the catalyst for a number of fundamental shifts that were long overdue and necessary for the continued growth and development of India overall. And as with many economies globally, this crisis will be remembered as the one that served as the catalyst for the establishment of a robust wealth management industry in India.

India's wealth management services sector remains largely fragmented, which isn't surprising given the industry is still in its early days. The industry remains nascent with many challenges in line with a fast-growing but young industry.

The regulatory environment in the Indian wealth management space is evolving, presenting challenges as well as opportunities for established wealth managers to expand their offerings. Regulations covering fiduciary duties and investor protection are imminent. The changing tax regime in every annual budget cycle is adding some uncertainty, which could potentially change product offerings dramatically.

Despite the mind-boggling statistics of the demographics and the market opportunities, very few, if any, established wealth management businesses are profitable. In fact the promise of growth and market size attracted many new players' pre-crises leading to a significant increase in the cost base which is now proving to be unsustainable. There have been a number of business closures and/or significant downsizing within the industry in the past 12 months.

Despite these challenges, or perhaps because of it, the industry has found its wings. We may still have a way to go but the catalysts are at play. Industry publications such as this go a long way towards ensuring we are all moving in the right direction - but in order to ensure we are successful in establishing a robust wealth management industry, we all have our own part to play.

At Religare Macquarie Private Wealth, we take pride in our core proposition of providing investors with advice-based "Simplified Wealth Solutions" which rest on three core pillars comprising knowledge-led people, best-practice processes and world-class investment solutions.

I hope you derive value from the insights in this publication.

Rohit Bhuta
Chief Executive Officer
Religare Macquarie Private Wealth





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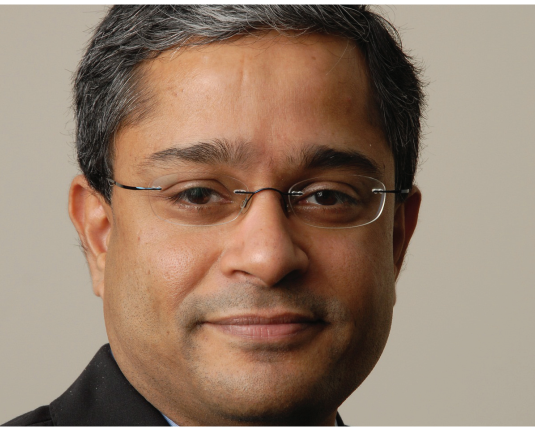



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ROLE OF RATINGS
Star ratings are universally-accepted indicators of grading systems. They tell the user instantly about the conclusion of detailed analysis – whether they are referring to hotels, restaurants or movies. Star ratings have also come to dominate the world of retail mutual funds.

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Feature article

HOW WEALTHY IS INDIA?

India is not considered a wealth country, when measured by wealth by per capita. In fact, on this measure, it is one of the poorest in the world, excluding Africa. Yet these figures hide a huge disparity in wealth distribution – India has a disproportionate share of dollar billionaires and millionaires in comparison with the rest of the world. This is why the Indian wealth management industry is considered to hold immense potential.

So how wealthy is India? There are various global reports that estimate wealth using different techniques. While most reports focus on the high net worth (HNI) population, reports such as the Credit Suisse Global Wealth Report estimate global household wealth across the spectrum from the very wealthy to the bottom of the pyramid.

The study assembles data on household wealth from a variety of sources to produce estimates of the level and pattern of household wealth across individual adults.

The third Credit Suisse Global Wealth Report, issued in October 2012, estimates global household wealth in mid-2012 to be around US$223 trillion.

> “Similar to most countries in the developing world, India’s personal wealth is heavily skewed towards property and other real assets.”

Changes in household wealth in 2011–2012 by region

	Total net wealth	Change in total net wealth		Change in financial assets		Change in non-financial assets	
	2012 USD bn	2011–12 USD bn	2011–12 %	2011–12 USD bn	2011–12 %	2011–12 USD bn	2011–12 %
Africa	2,393	-127	-5.0	-112	-8.1	-42	-3.0
Asia-Pacific	50,724	-1,311	-2.5	-298	-1.0	-938	-3.1
China	20,190	562	2.9	233	2.4	367	3.4
Europe	69,351	-10,882	-13.6	-6,237	-14.9	-6,480	-12.1
India	3,193	-699	-18.0	-139	-20.8	-586	-17.4
Latin America	8,696	-760	-8.0	-447	-10.4	-450	-6.9
North America	68,173	882	1.3	361	0.6	403	1.5
World	222,719	-12,336	-5.2	-6,640	-4.6	-7,728	-5.8

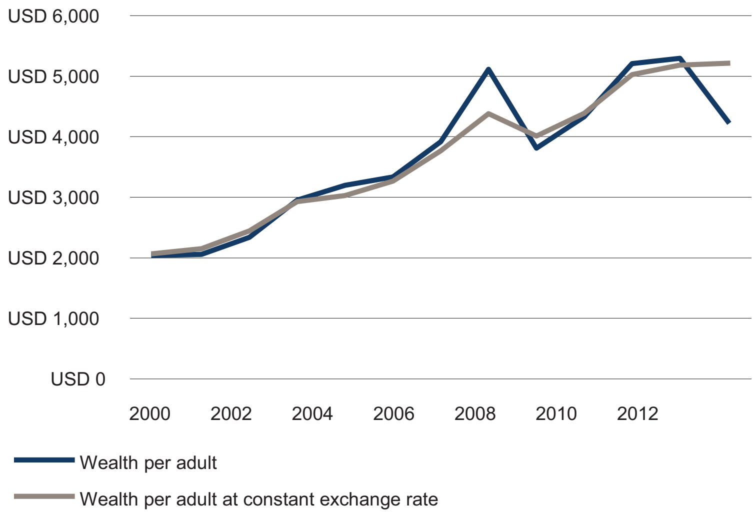
Source: James Davies, Rodrigo Lluberas and Anthony Shorrocks, Credit Suisse Global Wealth Databook 2012

India's household wealth is estimated around US$3.2 trillion.

India's wealth per adult has seen rapid growth from US$2,000 to US$5,300 in 2011. Given the 29% rise in adult population, aggregate wealth more than tripled during the same period. The US dollar figure is lower due to exchange-rate depreciation. Adjusted for exchange rate movement, wealth growth has quite steady since 2000, increasing at an average annual rate of 8%.

Similar to most countries in the developing world, India's personal wealth is heavily skewed towards property and other real assets, which make up 84% of estimated household assets.

Wealth per adult over time



Source: James Davies, Rodrigo Lluberas and Anthony Shorrocks, Credit Suisse Global Wealth Databook 2012

Personal debts are recorded at only US$162 per adult, but this figure probably underestimates debt as surveys in India suffer from under-reporting.

WEALTH DISPARITY

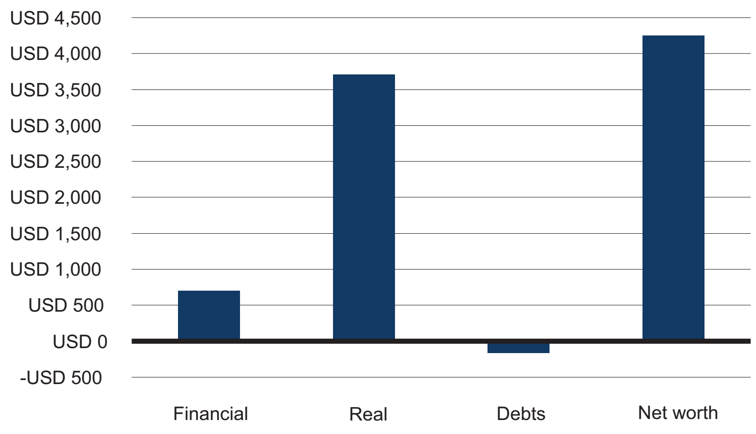
While wealth has been rising strongly in India, and the ranks of the middle class and wealthy have been swelling, not everyone has shared in this growth; there is still a great deal of poverty.

This is reflected in the fact that almost everyone (95%) of people in India has wealth below US$10,000.

At the other end of the scale, just 0.3% of the population has a net worth over US$100,000. However, due to the size of India's population, this translates into 2.3 million people.

India has 237,000 members of the top 1% of global wealth holders, which equates to a 0.5% share. There are 1,500 ultra high net worth individuals (UHNIs) with wealth of over US$50 million, and 700 with more than US$100 million.

Composition of wealth per adult



Source: James Davies, Rodrigo Lluberas and Anthony Shorrocks, Credit Suisse Global Wealth Databook 2012

Further, India is host to just 3% of the global middle class, defined as those with US$10,000 to US$100,000 range.

When looking at wealth deciles across regions, the contrast between India and China is striking. China has more representatives at the bottom of the global wealth distribution and relatively few at the top, but dominates the upper-middle section. This shows that the wealth inequality remains modest by developing country standards.

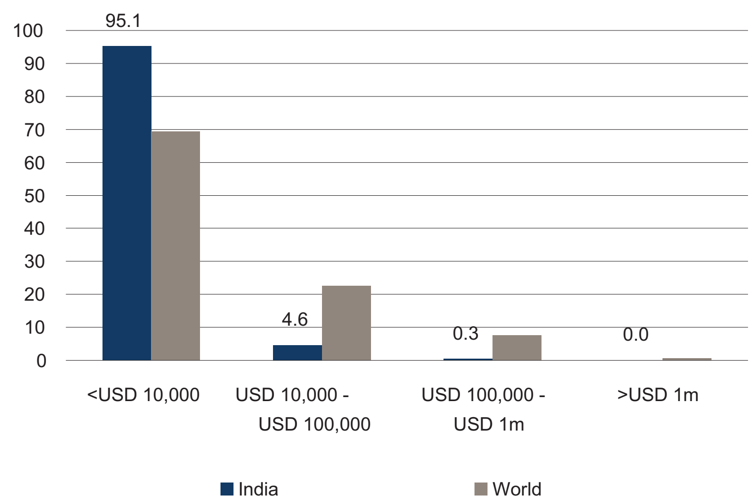
In contrast, India's residents are heavily concentrated in the lower wealth strata, accounting for a quarter of the people in the bottom half of the distribution chain.

This feature of extreme wealth inequality places a significant number of members in the top wealth echelons as well.

The Credit Suisse report predicts world wealth to grow to US$330 trillion by 2017, with China moving ahead of Japan as the second-wealthiest country.

China and India are expected to lead the growth of the "middle segment" – the US$10,000 to US$100,000 band – adding 275 and 40 million adults in this segment respectively.

Wealth distribution relative to world (in %)



Source: James Davies, Rodrigo Lluberas and Anthony Shorrocks, Credit Suisse Global Wealth Databook 2012

THE MILLIONAIRE POPULATION

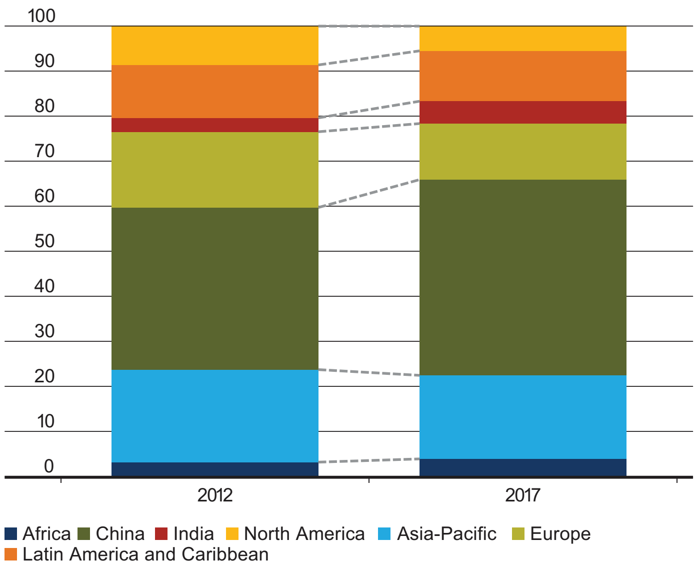
Turning to the main target audi-ence for the wealth management industry, the millionaires, the Credit Suisse report estimates India has 158,000 millionaires, predicted to rise to 242,000 by 2017.

It is worth noting that the Credit Suisse methodology calculates "net worth" by including the value of financial assets plus real assets, ie including housing, less debts.

Another of the longest-standing reports, the CapGemini World Wealth Report, measures by the concept of "investable wealth", which does not include the value of personal assets and property such as primary residences, collectibles, consumables and consumer durables.

The 2012 edition of that report, in conjunction with RBC Wealth Management, estimated India's HNI population to be around 126,000 with around US$477 billion in wealth in 2011.

Middle segment (% of adults)



Source: Credit Suisse

Equity-market capitalisation plunged in India in 2011, wiping out asset values and levels of investable wealth. This helped to reduce the size of the country's HNI population by 18%.

Meanwhile, The Julius Baer Wealth Report in September 2012 estimates the number of HNIs in India to be 172,000 with wealth of US$949 billion.

> The Kotak CRISIL Top of the Pyramid report estimates more than 81,000 ultra high net worth households with net worth of more than US$5 million (INR 250 million) in 2012. This represents 0.03% of the total households in India.

While all these reports estimate wealth on a top-down basis, firms such as Forbes and Wealth-X calculate their figures for HNIs and UHNIs on a bottom-up basis.

According to the 2012 Wealth-X report, for example, the Indian UHNI population shrank by 485 individuals, reducing the ranks of the ultra-wealthy by 5.9% to 7,730 individuals, and their wealth by 5.7% to US$925 billion.

The individuals in the US$500 million to US$749 million tier saw the largest percentage decrease in numbers, falling by -7.4% in terms of population; and the US$50 million to US$99 million tier saw the greatest loss at -12.5%.

The report estimates 109 billionaires in the country, representing 1.4% of the UHNI population and controlling 20.5% of the total fortune attributable to the ultra-wealthy segment.

Local reports in India also estimate private wealth. The Kotak CRISIL Top of the Pyramid report estimates more than 81,000 ultra high net worth households with net worth of more than US$5 million (INR 250 million) in 2012. This represents 0.03% of the total households in India. The number of UHNI households is expected to triple to over 286,000 by 2017.

The report confirms that entrepreneurship is the dominant source of wealth in India, but fast-growing service industries such as technology and financial services, too, have catapulted many hitherto middle-income group households into the UHNI bracket.

Meanwhile, Karvy Private Wealth's India Wealth Report estimates private wealth held by individuals by summing the proportion of individual holdings in all financial asset classes.

The November 2012 edition to be around INR 92.26 lakh crore (or

Happily for luxury product makers, most UHNIs refuse to acknowledge there is a downturn when it comes to spending.

US$1.81 trillion) in FY 2012, an increase of 7% on the previous year. The report estimates total individual wealth to double in four years. Investments in debt instruments form a major part of individual financial wealth with 72.35% being invested in this asset class. This was further boosted by deregulation of the savings bank deposit rate and increase in small savings returns. Direct equity was also a significant asset class with about 25% share. Nearly 20% is invested in insurance products.

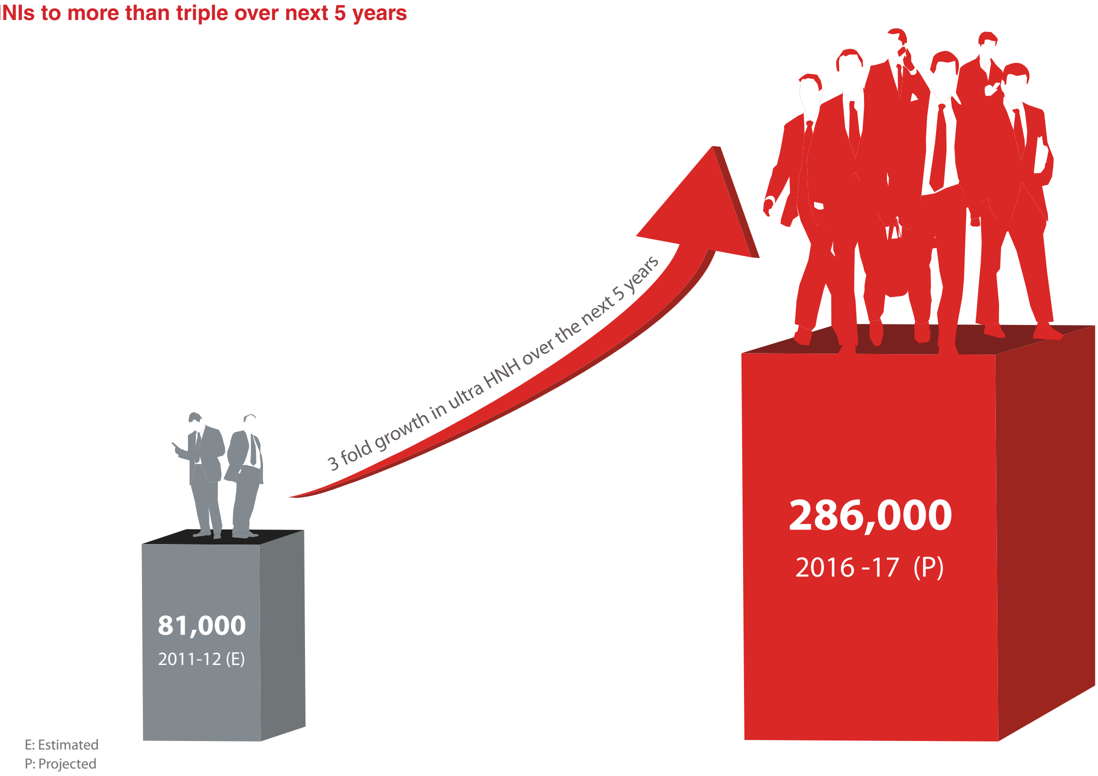
THE COST OF LIVING (EXTREMELY) WELL

The Consumer Price Index is the most commonly-used measure of inflation – but is primarily aimed at the common man.

Since the wealthy consume a completely different basket of goods and services, Forbes came up with the Cost of Living Extremely Well Index (CLEWI) to provide a price fluctuation barometer for the ultra-wealthy. And the CLEWI tends to outpace the CPI.

Indeed the CLEWI rose 2.6% in the 12 months to August 2012, outpacing the CPI's 1.4% rise marking the eighth time in 10 years, when inflation for the wealthy has been higher than that for the common man.

Ultra HNIs to more than triple over next 5 years



Source: T.O.P. India - Kotak Wealth & CRISIL Research

Julius Baer Lifestyle Index

Item	Specification	Average price across countries, in USD Current year	1 year ago	Average inflation %
University fees	Oxford/Harvard	60,363	51,016	18.3
Business-class flight	Return to London/New York	7,211	6,121	17.8
Residential property	4,000 sq ft top location	19,000,263	16,847,143	12.8
Watch	Gold Rolex Oyster	35,679	32,102	11.5
Ladies' handbag	Chanel quilted bag	4,583	4,185	9.5
Wedding banquet	500 persons at top hotel	99,602	92,146	8.1
Wine	Lafite Rothschild 2000	3,587	3,336	7.5
Jewellery	Tiffany 2-carat diamond ring	122,493	115,211	6.3
Men's suit	Giorgio Armani	5,819	5,532	5.2
Facial aesthetics	Sculptra liquid face lift	19,370	18,504	4.7
Piano	Steinway grand	207,701	201,021	3.3
Hotel suite	Four Seasons 6-star	670	652	2.8
Car	Mercedes 500 SEL	329,539	321,522	2.5
Root-canal treatment	Top local dentist	1,544	1,510	2.2
Cigar	Cohiba siglo VI	772	760	1.5
Lawyer	Family law, partner 1 hour	523	519	0.7
Boarding school	Eton/Deerfield average	51,883	51,499	0.7
Hospital	1 day top-end hospital	445	443	0.6
Golf club membership	Top local golf club	300,373	304,818	-1.5
Ladies' shoes	Classic Louboutin pumps	1,753	1,868	-6.1
	Lifestyle Index Inflation weighted average across 4 cities			8.8

Source: CLSA,Julius Baer

The index was launched in 1976 based on 40 goods and services reserved to the very rich customers. The components of the index include goods and services from various categories including Arts and Entertainment, Dining, Fashion, Sports & Leisure, Travel and Vehicles.

Julius Baer launched a Lifestyle Index in its inaugural wealth report in an effort to capture the changes in the cost of living for HNIs in Asia.

The Index comprises 20 items, capturing goods and services, in Mumbai, Shanghai, Hong Kong and Singapore. Property represents 30% of the index, the Mercedes 500 SEL 10% and the other items equally weighted at 3.3%. The index rose 11.7% in US dollar terms in the 12 months between April 2010 and April 2011.

The 2012 survey, outlined in the Julius Baer Wealth Report Asia, released in September 2012, shows an aggregate increase of 9% in US dollar terms.

Mumbai saw the highest price rises, at almost 20%, in local currency with the single most expensive item on the list to increase being the price of business class airfares. Mumbai had the highest range of price changes. The report is consistent with other studies concluding that the price rise for the wealthy is higher than the traditional CPI measures. This has implications for calculating "real" returns from investments.

The report also found a variation in prices across the four cities.

The Kotak CRISIL Top of the Pyramid Report 2012, meanwhile, provides insight to the spending pattern of wealthy Indians based on a survey.

In what most people would agree was a difficult year, the survey found that the overall trends in spending amongst Indian UHNIs was consistent with what has been observed amongst the global jet-set – there has been hardly any scaling down on purchases of items that qualify as non-discretionary.

The most important issues facing business-owning families are family-based, rather than strategy or growth.

Happily for luxury product makers, most UHNIs refuse to acknowledge there is a downturn when it comes to spending. Surprisingly, over 60% of those who said there was no slowdown were from the non-metros. "There is nothing wrong with the economy, but the fact that people are comparing growth levels to 2008 levels. That was an exception and cannot be used as a benchmark since we might never reach those levels again," one of the UHNIs opined.

A number of items that may qualify as luxury to most other individuals are essential (non-discretionary spends) items for the super-rich.

Unless they have been rousted out of the rich league due to some business or financial calamity, most UHNIs find it unthinkable to curtail their spending or change their lifestyle because the economy is facing a few jitters. One of them voiced thoughts echoed by many: "We are used to a certain

Prices of Julius Baer Lifestyle items across cities, in USD

	Hong Kong	Singapore	Shanghai	Mumbai
	59,757	59,756	59,868	62,070
	8,902	8,182	6,666	5,095
	40,401,021	12,975,134	15,870,749	6,754,149
	32,207	33,341	38,572	38,595
	4,921	5,781	4,888	2,740
	121,100	67,482	111,406	98,418
	4,380	3,349	3,492	3,126
	116,452	159,910	186,711	26,631
	5,926	3,998	6,983	6,368
	9,018	2,559	2,393	4,197
	197,496	231,870	250,917	150,521
	624	959	667	433
	229,832	402,085	348,531	337,707
	3,350	1,839	524	463
	466	1,375	667	579
	386	660	794	251
	51,363	51,362	51,457	53,349
	464	756	333	229
	386,489	239,866	285,673	289,464
	1,005	2,714	1,460	1,833

Source: CLSA,Julius Baer

Profiling the wealthy

The Forbes Insights, Global Wealth and Family Ties, analysed 1,253 of the world's largest fortunes in 12 countries, including 100 in India, from the perspective of family involvement in running the business. The report studied the various factors that determine whether family members are involved in running the business in a bid to understand the current state of fortunes and indications about possible future wealth patterns.

The report found that India had amongst the highest percentages of family-run fortunes at 73%. Indeed, family-managed fortunes tend to cluster in some regions of the world and hardly exist in others. India, along with Hong Kong (75%), France (64%) and the Middle East (62%) had more family involvement, while Russia (19%), the UK (25%) and China (33%) had the least.

In emerging markets such as India, businesses and family businesses are still in the early stages of the lifecycle of wealth creation.

The report mentions that India is unique in the sense that its many newer self-made fortunes, created after 1991, also have strong family ties, much the same way older businesses were run. Indian society expects strong family ties, just as it values education highly. The combination of these factors has meant that younger members of the family are sent overseas for education and attain some work experience before being inducted into the family business.

Family businesses have their own set of challenges. According to local family business adviser, Sunil Shah of Evergreen Family Business Advisors: "The most important issues facing business-owning families are family-based, rather than business strategy or growth. We are new at dealing with the overlap between the three roles of a family member, business co-owner and co-manager in our family businesses."

Professor John Ward, another expert on family issues, cites sibling rivalry as the main issue facing family businesses. "I find, in general, that the transfer of leadership from the senior generation to the next generation works a lot better in India. But the number-one challenge in India is rivalry and conflict between siblings."

In relation to succession planning, Ward says: "I think because Indian families are small the transition from senior generation to the next generation is somewhat smoother than in other parts of the world. Succession planning is important but less problematic in India. The greater question is continuity planning, which is investing in the culture and governance of the business for the long-term future."

lifestyle and it is not easy to change it, even if there is a slowdown – it is not impacting us so much that we need to change or cut our lifestyle."

The report highlights preferences for a number of spending categories including education, travel and weddings.

It also included a special focus on luxury cars which mentioned that BMW, Audi and Mercedes were the top three aspired cars. While a Bentley or a Bugatti still signifies luxury, the ultra-wealthy define luxury by what they can purchase in the immediate future. But they also want exclusivity.

This is highlighted in the Capgemini Wealth Report Asia Pacific 2012 which mentions that the luxury car is now sized at US$1 billion, and is expanding at a rate of 40% a year. For example, Lamborghini's Aventador LP 700-4 (priced at INR 36.9 million or US$796,000), was introduced into India recently, and received more than 20 orders and hundreds of queries despite a waiting period of 18 months.

BIG POTENTIAL

In summary, while estimates about the wealth in India vary, the size is significant enough to be taken seriously by a number of stakeholders: the policymakers who would like to be invested productively to further economic growth; the financial services industry generally, which would like to intermediate the investment; and the wealth management industry specifically, which would like to advise the HNIs on their investments.

Even if the Indian wealth management industry focuses on the HNI population and affluent individuals, as it does right now, these figures show ample potential. ■

BANK: HDFC BANK

HDFC Bank has been in the wealth space for more than 10 years. Being India's leading private sector bank, which has won accolades from top national and international organisations, it provides advisory and investment-based execution services to all segments of investors in the country.

“HDFC Bank is the market leader in all aspects of business, whether it is assets under management, number of clients, product offerings across segments and geographies, or insurance premium mobilisation.”

HDFC Bank is the market leader in all aspects of business, whether it is assets under management, number of clients, product offerings across segments and geographies, or insurance premium mobilisation.

Typically, the bank's target segment of clients ranges from entry-level customers for core distribution products and progresses, to customers in the INR 1 crore to INR 10 crore segment in private banking, to greater than INR 10 crore in the ultra high net worth investor (UHNI) space. The bank's target segment also constitutes corporates which have investment needs.

The core wealth business of HDFC Bank covers 29 main locations and 62 spoke locations, and offers structured advisory-based services across the country where the bank has more than 160 specialised private bankers.

Further, the other business of distribution of mutual funds and insurance is also spread across the widest geography where the bank has more than 3,000 certified staff to distribute investment products across the country.

Recently, HDFC Bank has ventured into Middle East markets with an offering for non-resident Indians.

As an institution, the bank is very conservative and hence advises conservatively as well. It refrains from high-risk asset categories and funds which tend to offer abnormally-high returns and recommends only those products which are backed by the central research team.

In the core business of private banking, the entire value proposition revolves around asset allocation, with a focus on equities and product innovation across banking and investments. The bank's offering includes advice on the direct equity portfolio, customised debt based solutions, estate and succession planning, portfolio management services, innovative structured product opportunities in line with client needs, view-based product options, investment banking solutions, real estate referral services in partnership with external consultants, and tax consulting.

Additionally, HDFC offers banking services in its entirety from personal to corporate.

The bank offers the basic services of distribution of mutual funds and insurance products to customers.

In the core business of private banking, the focus is heavily on structured sales processes in addition to basics like profiling to protect customers' interests.

Thus, the foundation of the core business is a close monitoring of advice to the customer and a sales audit on advisory process management and research process management which is independently run by the compliance division.

In the segments which are distribution-oriented, this is reflected through a stringent after-sales process for monitoring and controlling the quality of sales made by independent divisions.

> "The bank's strategy is to successfully adapt to the ever-evolving economic and regulatory landscape while providing customised solutions to create and manage wealth for their clients."

> "HDFC Bank invests heavily in grooming and developing people, and it believes in a mix of young and experienced talent."

HDFC Bank also invests heavily in grooming and developing its people, and it believes in a mix of young and experienced talent as a workforce of advisers / specialised staff for distribution.

As a result, at least 10% of the advisers in the core business are fresh graduates from business schools whom the bank grooms and builds.

The bank's strategy is to successfully adapt to the ever-evolving economic and regulatory landscape while providing customised solutions to create and manage wealth for their clients.

In the changing regulatory landscape, due to the flexibilities built in the model, the bank stands to benefit in the UHNI segment, in the NRI space, and in the B15 segment of cities which will continue to see high growth in the foreseeable future. ■

Firm profile

BANK: STANDARD CHARTERED

Standard Chartered Bank's advertising tagline of "Here for Good" supports the London-headquartered bank's commitment to Asia, Africa and the Middle East where it has been operating for more than a century.

The centre of gravity for Standard Chartered Bank's wealth management business is Singapore, where the global heads for both the wealth and private bank are based.

The bank has been offering its wealth management services for the affluent segment for a while; however, its foray into private banking is relatively recent with the acquisition of American Express Bank about five years ago.

Hence, the private bank relies on the wealth business for support, for example in areas like investment advisory and product research.

In India, the two business divisions appear seamless. They are led by Sandeep Das as the business head for private banking, and Vishal Kapoor taking the responsibility for wealth management.

Presently the bank has US$7 billion in AUM serviced by over 700 relationship managers and advisers.

Kapoor is optimistic about the wealth management industry's prospects in India, including for entrepreneurs in the

"[Standard Chartered Bank] woos [entrepreneurs] with not only the usual banking and cash-management services but also networking with other like-minded players.

Standard Chartered Bank's comprehensive product platform is augmented with signature fund and securities portfolio services, Islamic financial solutions, fiduciary services, insurances services and credit facilities.

Vishal Kapoor

Standard Chartered

small-to-medium enterprise segment, for whom the bank has focused.

Kapoor wants to be able to serve the high aspirations of these entrepreneurs.

He says they have "lots of paper money, some presently undervalued but with huge potential in the future".

The bank woos them with not only the usual banking and cash-management services but also networking with other like-minded players.

Says Kapoor: "In terms of where we see value addition for the customer, the focus is not just the use of balance sheet, lending or deposits; the focus is on quality advice.

This includes getting the customer's knowledge quotient up, and providing advisory value addition."

Standard Chartered's comprehensive product platform is augmented with signature fund and securities portfolio services, Islamic financial solutions, fiduciary services, insurances services and credit facilities.

The bank relies on "homegrown talent", having developed training programmes for recruits.

Detailing the merits of the training programme, Kapoor says: "The frequency and the width of our training programme is what makes it different from other such industry initiatives."

He adds that the bank has a well-developed international graduate programme.

"We combine classroom training and CBT with mentorship. This, we feel, is fundamentally different," says Kapoor. ■

Co-published with Religare Macquarie

UNDERSTANDING YOUR INVESTOR PSYCHOLOGY

Understanding how decisions are influenced by behavioural biases can help investors avoid some of the traps of investing. We look at a recent academic article, which provides some useful insights into financial decision-making.

Behavioural finance or behavioural economics is the study of the psychological biases that impact decision-making. Traditional economic modeling assumes that people make decisions rationally, taking into account all available information (adjusted for the cost of gathering and analysing the information).

However, increasing evidence, or rather, obvious fact, suggests that people's decision-making is influenced by certain behavioural biases and has led to a growing body of work investigating the impact of these biases on financial markets. This research aims to provide descriptive models of how markets operate rather than theoretical models of how they should operate.

An important paper by Daniel Kahneman and Amos Tversky, Prospect Theory: An Analysis of Decision under Risk, published in 1979, provided an in-depth analysis of areas where standard economic theory seemed to falter and provided examples of human psychology or biases that could explain these anomalies. Kahneman was awarded the Nobel Prize in economics in 2001 for his work on "integrating insights from psychological research into economic science".

The impact of psychology can be clearly seen in investor behaviour, such as herding. This can lead to bubbles and crashes and fear of regret, where investors avoid selling a poorly-performing investment because they do not want to admit to having made a bad decision to begin with.

Understanding how emotions or psychology can impact our decision-making can help us avoid some of the investment traps investors can fall into.

THE EXPERIMENT

A recent article, The Most Destructive Behavioral Bias, by Todd Feldman, published in the Journal of Investing, uses some interesting modeling techniques to test which behavioural biases are most likely to lead to poor investment performance. Four behavioural biases are considered:

- **Overconfidence** - investors believe that their decisions are superior to those of others and, as a result, they are more inclined to make risky investments

- **Recency** - investors tend to put more emphasis on the recent past when making decisions about the future, expecting that the future is more likely to look like the recent past. This is also known as anchoring

- **Loss aversion** - investors may "feel" losses more keenly than gains and may therefore sell loss-making investments more quickly

- **Disposition affect** - investors sell their "winners" too early, but hold on to "losers" for too long.

In the experiment, there are four groups of investors with specific behavioural biases. A virtual investment market is simulated based on the decisions of the different group of investors. Depending on the bias of the investors, a different proportion of funds are invested in equities compared with cash. The investors rebalance each period based on the move in the share market and their specific way of investing. For example, the rational investor will rebalance their investment portfolio each month back to their initial position, which is based on the long-run variance of the share market. So, if the initial investment is based on a 60:40 split in favour of equities, this will be maintained by rebalancing back to this proportion each month.

In contrast, rather than using long-run variance in their calculation of what proportion to invest in the share market, the "recency" investor puts more weight on the recent past. If the market has been through a period of high volatility, this investor will decrease the amount invested in equities, because they assume that the high volatility will continue.

The "loss-averse" investor considers risk based on losses rather than volatility. So, in the experiment, this investor lowers the exposure to equities if the market is volatile to the downside. Finally, the "disposition" investor either buys more or does not sell when the market is falling, but tends to sell when the market is going up.

RESULTS

Feldman finds that putting too much emphasis on the recent past (that is the recency investor) tends to lead to the greatest underperformance. While the loss averse and disposition investors also underperformed compared with the rational investor, the amount of underperformance was not as extreme.

An interesting result was that the amount of trading differed depending on the type of investor, as would be expected, but this was not the main determinant of the underperformance. For example, the loss-averse investor tends to do the most trading, which increases their transaction costs, but this does not lead to them having the lowest return.

The Feldman study is a specific analysis of the impact of certain behavioural biases. It does not take into account that investors invest in more than just equities and cash, and Feldman models the problem through a computer simulation rather than using real financial data. Nevertheless, it does provide an insight into what may be happening in the current environment where recent extreme market moves are now being considered the norm and investment decisions are being made on this basis. While the preference for the relative safety of cash and fixed interest might be understandable sometimes, the study shows that the long-term consequences may be sub-optimal.

CONCLUSION

Emotions and psychology play an important role in financial investment decision-making. Understanding your own biases as an investor and putting in place processes and techniques to avoid or decrease the impact of these biases should be an essential part of a disciplined approach to investing. For example, before buying a stock you should determine your exit strategy: at what level you will sell the stock and take profits, or at what point you will sell the stock despite not having made a profit.

This way, if the stock price has fallen 10%, for example, and this was your limit, you will not be tempted to hold the stock on the possibility that it bounces back. Similarly, if the stock price rises by 10% in the month following purchase, you should consider selling rather than holding on the expectation of further rises. These limits don't need to be inflexible or unbreakable; they are a reminder to consider the original reason for the investment and to assess if it has changed.

In some cases, the decision may be made to keep a stock when the predetermined limits have been reached. For these reasons, a financial adviser provides an important sounding board for an investor. An appraisal of the investment matter at hand without the emotional baggage, which often goes with money matters, can help clarify the current investment environment and ensure that investment decisions are in keeping with long-term goals. ■

Feature article

DEFINING THE WEALTH MANAGEMENT INDUSTRY

In some respects, the Indian wealth management industry is still struggling to come up with an identity.

When one speaks to the business community or broader financial services industry, they assume wealth management means private banking – advice to the wealthy only. Globally, it actually means brokers and distributors of mutual funds and insurance products that service the affluent and mass investors.

The industry often gets compared to a chemist – distributors stock a range of products but don't really give advice.

Only now are they being asked to become doctors and diagnose the client situation and recommend the best course of action. Hence, we are seeing the industry evolve from being distribution-led to becoming advisory-led.

TYPES OF PLAYERS

The mutual fund industry divides its distributors broadly into three categories: banks, national and regional distributers, and independent financial advisers (IFAs).

The banks and IFA categories are fairly straightforward – banks have banking licenses, while IFAs are usually individuals without any organisations to support them. There are some firms like Merrill Lynch/Bank of America, or Morgan Stanley, which do not have banking licenses in India but tend to get referred to as private banks.

Most industry players peg the market share of the segments as roughly equal among banks, national distributors and IFAs, based on known revenue sources like mutual fund commissions. But there are no confirmed assets under management (AUM) or revenue figures available for the industry.

There are different types of banks and each is at different stages of evolution in its wealth management offering.

TYPES OF PLAYERS

Types of player	Examples	Characteristics
Banks	Global universal – Citi, HSBC, Standard Chartered	Developed wealth management offering Coverage of Tier 1 cities
	Local universal – HDFC, ICICI, Kotak, Axis Public sector banks – SBI, Bank of Baroda	Developed lending offering Good reach Large players, relatively low entry levels for wealth management ser vices Cross -sell potential with retail/corporate network
	Global wealth specialist – RBS PB, Deutsche PWM, BNP Paribas , Barclays	Primarily foreign players with focus on advisory and offering of managed/structured products Wide range of wealth management entry levels, typically high entry barriers
	Global investment banks – Credit Suisse, Morgan Stanley, UBS	Focus on ultra high net worth segment Institutional approach to serve clients with investment banking products
Broker/dealers	Local investment banks – Edelweiss, Avendus, Ambit	Focus on ultra high net worth segment Institutional approach to serve clients with investment banking products
	DSP Merrill Lynch, ICICI Direct, Karvy, Motilal Oswal, Religare/Religare Macquarie	Wide range of brokers targeting mass affluent and high net worth Domestic equity/mutual fund focus
National/regional distributors	Non -bank institutional – Reliance Money, Tata Capital, Aditya Birla Money,	Mostly focus on mass/affluent although also have high net worth offering
	IFAaggregators – NJ Group, Bajaj Capital	Mostly focus on mass/affluent although also have high net worth offering Commission driven model
IFAs	(examples included in this Guide) Dhruv Mehta, Plan Ahead	Serve clients across segments
Family offices	Client Ass ociates	Holistic advisory services for ultra high net worth or specific client segment such as entrepreneurs, professionals

The global universal banks such as Citi, HSBC and Standard Chartered, for instance, have relatively-evolved wealth management offers as they have adapted global processes to the local environment. These, along with local universal banks like HDFC, ICICI, Kotak and Axis dominate the AMFI-published mutual fund commission list as the largest single entities.

Says Sundeep Sikka, chief executive officer (CEO) of Reliance AMC: "Banks get a lot to the table. Their research proposition can't be matched."

A Balasubramaniam, CEO of Birla Sun Life AMC also like the potential of banks: "In terms of capability, I think that the bank has more access to clients much more efficiently than any financial advisers, hence the banking model will be more successful."

A force with the potential to change market dynamics is the entry of public sector banks. The chairman of the largest of public sector banks, State Bank of India, has previously announced its intention to aggressively launch and expand its wealth management offer.

The launch has been low key so far – few in the industry know that SBI made a significant investment in financial planning technology, which helps relationship managers churn out written financial plans. But without

Sanjay Sachdev

(Formerly with) TATA Asset Management

"So long as the IFAs are going up the value chain, no-one can match the personal relationship that IFAs tend to build up"

an adequate plan to train and incentivise staff, the bank hasn't been able to penetrate its extensive branch network, let alone its vast client base.

However, given the combination of their phenomenal brand, reach, corporate relationships and ability to invest in technology, public sector banks could be a formidable competitor in the mass affluent segment.

The national and regional distributors are a mix of large non-bank institutions that have diversified businesses, either through insurance and asset management such as Tata Capital, Reliance Money, and Birla Money, or in broking such as Karvy, Motilal Oswal, Religare, Anand Rathi, etc.

They could also have evolved out of investment banking such as Ambit, Edelweiss, Avendus, etc. On the other side of the spectrum are the IFA "aggregators" such as NJ Group and Bajaj Capital, who have broking operations but not the balance-sheet size.

However, national distributors do not like being tagged as such.

At a recent roundtable organised by Hubbis, some of them highlighted that they were "independent" and hence, would prefer to be called "wealth advisory" firms.

Sikka likens national distributors to banks: "National distributors almost fall in the same category as banks. So long as they have a strategy where it revolves around the investor, they can be successful."

A number of other CEOs of AMCs prefer working with IFAs.

Sanjay Sachdev, former CEO of TATA Asset Management reflects the views of many: "We follow a three-tier model, but IFAs are at the core of our distribution model. We work a lot with IFAs… so long as the IFAs are going up the value chain, no-one can match the personal relationship that IFAs tend to build up. They might emerge as one of the strongest categories."

There has been a lot of debate amongst these categories about whose actions have led to the perception of mis-selling in the eyes of the media and regulators. However, most industry practitioners have come to the conclusion that such categorisations are meaningless and no blame can be laid on the actions of the organisation or indeed individual advisers.

Asked about whether AMCs follow a distribution strategy for each of these categories, CEOs of AMCs didn't have clearly-differentiated strategies.

Indeed, Sikka prefers designing his firm's strategy around the needs of the end-client rather than distributor categories: "At times a lot of the indus-

TYPES OF PLAYERS

Client segment	Global definitions Client Net worth	Indian definitions 'Investable assets'
Mass	<USD 200k	INR 3 - 10 Lakhs (USD 6k - 20k)
Affluent	USD200k – USD 1m	INR 10 - 60 Lakhs (USD 20k – 120k)
Super Affluent	Part of affluent	INR 60 Lakhs – 5 Crores (USD 120k – 1m)
High net worth	USD 1m – USD 30m	INR 5 Crores – 50 Crores (USD1m – 10m)
Ultra High net worth	> USD 30m	INR 50Crores + (>USD 10m)

Hrishikesh Parandekar

Karvy Private Wealth

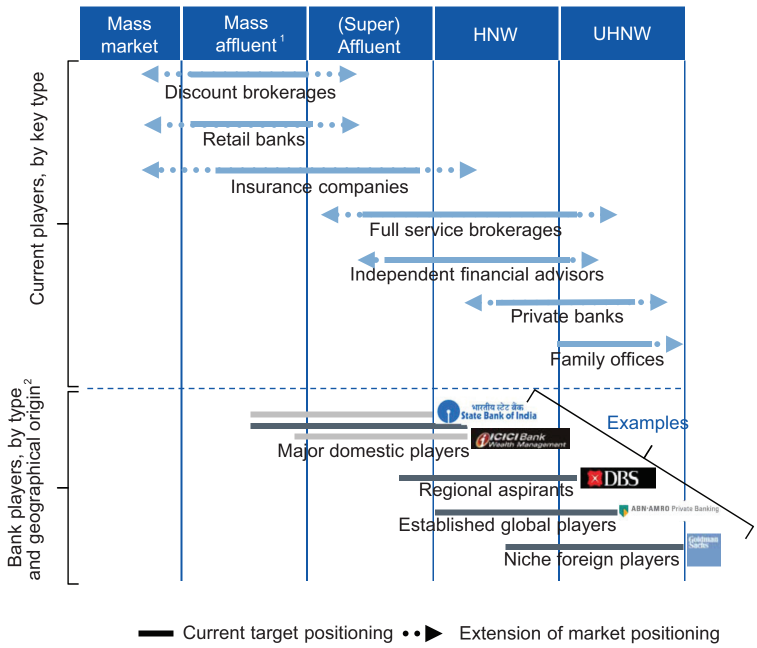
"Different client and market segments have been lucrative at different points in time"

try slice-and-dice based on distributor segments like IFAs, banks, etc, but it's more important to look at the needs of the end-investor, whether they are mass, affluent or high net worth. We look at what segment the distributor is trying to serve, and then try to have our relationship people with relevant skills aligned to those distributers."

Balasubramaniam agrees: "The wealth management industry can be divided into two parts: the distributor community which focuses on large pool of retail investors; and that which focuses on HNIs. And I think the HNI segment and its associated distributor community is growing."

In interviews with a number of CEOs of wealth firms throughout the Guide, they reveal their strategy on customer segmentation, service, product offerings and talent. Here, we have made general observations, and included comments from other stakeholders.

Market positioning of wealth management distributors



Source: Celent report, Oliver Wyman, Datamonitor

CLIENT SEGMENTATION

Most firms included in this Guide focus on HNIs and UHNIs, as defined in the table.

Some firms, however, believe that the sweet spot is just below the HNI segment and are therefore focusing on the "super affluent", or the top-end of the affluent category.

Some non-bank wealth firms also cater to multiple client segments. Hrishikesh Parandekar, CEO of Karvy Group, explains his firm's strategy is to focus on the affluent while still building a brand in the HNI segment.

"A major challenge for the wealth management industry has been different client and market segments have been lucrative at different points of time. Hence we have taken a broader approach to market and don't believe that wealth is limited to the millionaire segment only."

As the first chapter outlined, the HNI category does have huge potential. But Parandekar is of the view the seg-

Rajiv Anand

Axis AMC

"Appropriate incentivisation of the distribution community is absolutely essential"

ment is serviced well. "The millionaire segment continues to have a large ticket size potential but it has also been over-banked and has got very challenging to make money from."

McKinsey's private banking study also concluded that the UHNI segment is well serviced, but in the low-to-mid HNI segment there is a huge opportunity with revenue margins in the INR 5 crore to INR 50 crore segment.

The penetration is close to 8% to 10% so there is a huge upside in the market. "A lot of the HNIs are still managing their own private estate or through agents, and not investing the full share of wallet with private banks," says Saurabh Trehan of McKinsey.

Parandekar explains the problem with the HNI segment: "The conversation from the millionaire segment has become limited to a show-us-something-new conversation and they tend to ask for something new all the time."

According to strategy consulting firm Oliver Wyman, currently brokerages and retail banks control over 80% of the mass and affluent segments. On the other hand, foreign private banks control about 60% of the HNI and UHNI segments.

Aditya Birla Money is another non-bank wealth firm that has decided to target the affluent segment with the launch of a portal.

CEO Sudhakar Ramasubramanian outlines his client segment strategy: "So when we looked at the market and customers, the problems that the potential customers were having were two-fold: too many advisers and too many products, and they don't have clarity on what is right and good for them or their portfolios. At the same time, they also acknowledged that the investment process is complex and hence most of them shy away from it. So the task before us was to empower Indians to make better financial decisions and simplify the money management process for them."

Sikka of Reliance, however, believes the client segment affinity depends on value proposition rather than organisational background. "The requirements for different investors are different so success depends on what the value proposition is. For example, there is a perception that HNIs are catered to by Swiss private banks, but I have seen IFAs doing a good job. On the other hand, there is a perception that small investors are served by IFAs, but it could be that banks do a good job for small investors."

"Currently brokerages and retail banks control over 80% of the mass and affluent segments. On the other hand, foreign private banks control about 60% of the HNI and UHNI segments."

SERVICE AND PRODUCT OFFERING

While firms obviously want to le-verage any strengths they have on the customer acquisition side, most wanted to build both the breadth and depth of their service offering.

Wealth firms' service offering can be divided into the following broad areas:

- Banking
- Investment advice / execution
- Financial planning
- Wealth planning
- Lending

While banks start with the banking services, the main service offering for most of the firms is investment execution. Within investments, firms pride themselves on the breadth of the product platform. Usually it includes mutual funds, insurance products, direct securities, PMS and alternative investments.

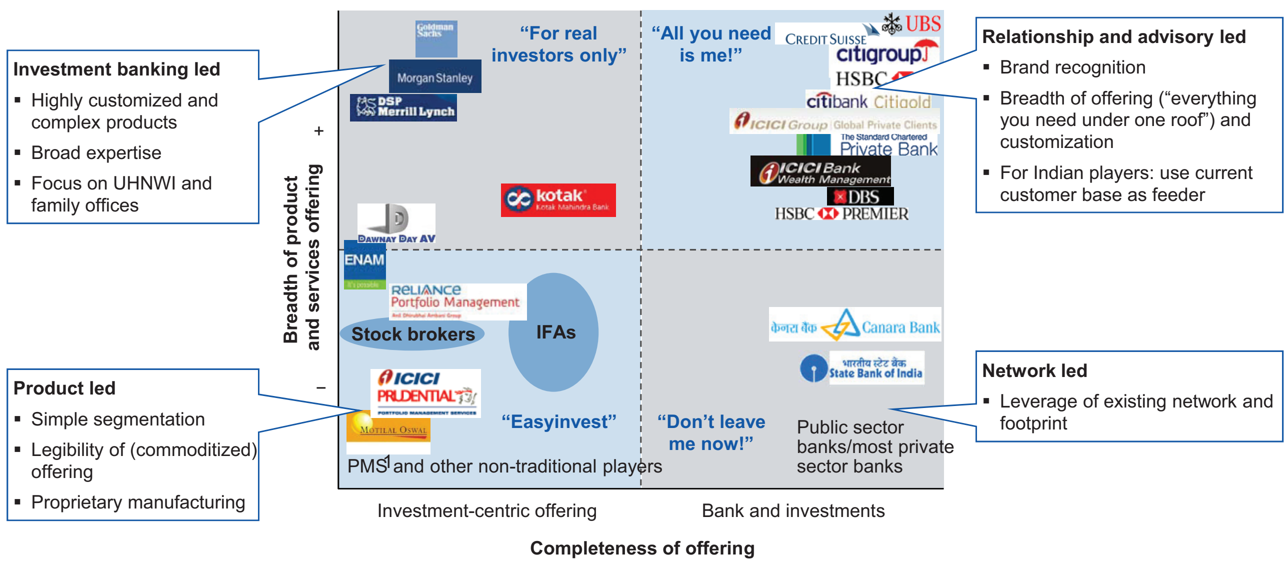
While the wealth industry constantly looks to provide a one-stop shop through a single point of contact, even portals like Aditya Birla's "MyUniverse" try to go beyond investments. Says Sudhakar: "Our portal is not only about managing investments, but about all aspects of money. It is about (i) aggregating all financial relationships in one place including bank accounts and loans, (ii) providing analytics and ad-

Sundeep Sikka

Reliance AMC

"It's more important to look at the needs of the end-investor, whether mass, affluent or high net worth"

Product range and offering focus



The positioning of a player along the "completeness of offering" axis reflects not only a deliberate choice of positioning, or the success in leveraging one's banking capacities for its wealth management offering, but is very much linked with its organisational model (for a bank: IB mainly, PB-focused, universal etc.)

1. PMS = Portfolio Management Services

Source: Celent report, Oliver Wyman, Datamonitor

Dhruv Mehta

Dhruv Mehta

"It is essential that the distribution community makes its own representation to the regulators"

visory based on risk & financial profile, and (iii) facilitating transactions."

Adds Parandekar: "Challenges in terms of structure of the industry, economics of the business and the regulatory changes continue, but I think the opportunity is huge and it will continue to be an attractive place for business."

PRIVATE BANKING ECONOMICS

As a segment of the overall wealth management market, the HNIs and UHNIs attract more attention, and with good reason.

For global private banks, the Indian private banking market showed stronger growth of around 17% in FY 2011 compared with the growth of most other markets of 6% to 9%. Domestic institutions are also interested in the HNI segment to complete their offering and get a share of a more profitable segment. Hence, the economics of this segment are of interest.

However, data on revenues and profitability is hard to come by in the wealth management industry.

The only formal survey we found was the McKinsey Private Banking Survey. The 2011 survey, released in December of that year, covered 12 private banks and HNI-focused advisers in India. (The 2012 survey was being collated as this publication went to print.)

According to the 2011 report, the Indian private banking market had experienced a very good year in 2011, with higher growth than most other markets and a doubling of profit margins driven by reduction in cost margins. This was after FY 2010 which showed 50% growth. The survey showed different business models and size of business impacts both revenue and cost-margins in the Indian market. Banks showed higher revenue margins as compared with pure advisers while sub-scale players have significantly higher cost margins as compared with scale players.

In a difficult environment, banks had increased revenue margins from 77 basis points (bps) in 2009/10 to 84 bps in 2010/11. On the other hand, revenue margins of advisers appears to be under pressure, falling from 53 bps to 36 bps.

Trehan of McKinsey explains there were two issues: first, the revenue margins were low as participants were focusing on the extreme top end of the market, the UHNIs, so their margins were lower; secondly, the profit margin of 30 bps is comparable with developed markets. Only the advisers focusing on UHNIs have lower margins.

While lower in other markets as well, there is a significant drop in India of 50% to 60% from the higher end."

"Banks showed higher revenue margins as compared with pure advisers while sub-scale players have significantly higher cost margins as compared with scale players."

Trehan believes that the margin pressure at the UHNI segment is partly because large family offices have started to employ their own professionals. "The larger family offices are just dealing directly with the institutional desks, especially if they come with a large corporate partner." Where the family offices do not employ their own staff, the competition is very intense.

The cost margins for Indian private banks of around 53 bps are approaching best-in-class levels. Even the Western Europe market had a cost margin of 59 bps while the cost leaders were Central and Eastern Europe and the US have cost margins of 50 bps and 52 bps respectively.

The cost margins have decreased over the last year, driven primarily by the reduction of sales and marketing costs, which includes the frontline adviser costs. Advisers had shown increased productivity though this differed across cities.

Cost margins fall as the overall business scales up. As the chart shows, the cost margin was 84 bps for players with less than US$400 million in AUM and 29 bps for players with US$2 billion in AUM. The average AUM per relationship manager (RM) was INR 215 crore (around US$43 million) and average revenue per RM was INR 1.3 crore (US$260,000).

Banks' profit margin was also significantly higher than the 7 bps for the industry as a whole. "The economics are very good for a lot of the banks," says Trehan, prefacing his advice to global banks, which was to offer services across the segment, not just the UHNI which may give AUM but not profitability. He suggests banks pay attention to the product suite and coverage model, so they can target the lower HNI, where there are better margins.

His suggestion on the product mix was to include "some kind of structured products, whether it's equity real estate or debt".

He agrees that "there was the issue of people simply investing in real estate but now that real estate advisory becoming part of the service offer, even that is an opportunity."

INDIA'S ASSET MANAGEMENT INDUSTRY

Globally, AMCs, also known as funds or investment management firms, offer professional management of financial or real assets through collective investment vehicles such as mutual funds or ETFs, primarily to private investors or through advisory mandates to institutional investors.

Since institutional investors include pension funds and life insurance companies, AMCs also end up managing pension and insurance assets. While the product or service offer may be regulated differently, the firms themselves tend to be regulated by the securities regulator.

In India, regulation tends to be along product lines. Hence, there are separate regulations for products aimed at retail investor (mutual funds), HNI (PMS) or pension (pension funds) segments. Products covering illiquid or risky investments are covered by different regulations, the Alternative Investment Fund (AIF) regulations.

Since mutual funds are aimed at retail investors, the barriers to entry are quite high. The minimum capital required is INR 10 crore (US$2 million). The organisational structure is also somewhat complicated with the sponsor (private company) setting up the mutual fund (with independent directors) that offers schemes overseen by the trustee board. There are stringent rules for the management of the schemes with minimum number of investors, minimum number of holdings, caps on single and sector exposures, valuation guidelines, etc to safeguard retail investor interests.

Over the years, the mutual funds industry started getting inflows from institutional investors such as corporate treasuries, primarily into the liquid or short-term cash funds because of tax benefits. The industry obliged with lower-fee institutional plans.

Hence, today institutional investors dominate the liquid and debt funds while retail investors are mostly invested in equity funds.

Rajiv Bajaj
Bajaj Capital

"While there may be different business models, the body could take up the 'common minimum programme'"

A Balasubramanian

Birla Sun Life AMC

"The bank has more access to clients much more efficiently than any financial advisers, hence the banking model will be more successful"

The industry was tested during the global financial crisis in 2008 when it faced a liquidity crunch in the cash funds. While the central bank intervened by providing the industry much needed liquidity, the AMCs did something peculiar too – they made good any losses suffered by their investors. The move strengthened the faulty assumption that retail investors had about mutual funds being guaranteed by the AMCs with good brands.

This move has continued to haunt the industry. While some industry participants feel that the minimum capital requirements are too high for an industry with pass-through vehicles, there are others who believe high hurdles should be retained to be able to continue honoring any losses.

The other significant event that shaped the industry was the abolition of entry loads in 2009. The mutual fund industry was shocked and in some respects still hasn't come to terms with it even three years later.

The latest round of mutual fund reforms were announced in September 2012, with increases in expense ratios as compensation for exit loads and incentive to increase penetration in smaller towns. The increases are significant, taking the expense ratios over 3% for equity funds.

The asset management industry has welcomed the move. HN Sinor, CEO of the Association of Mutual Funds in India (AMF) believes the extra fee is justified: "Given there is no load in the Indian market, unlike other markets that have 3% to 5% loads, the additional 0.5% to 0.75% is ok."

A large chunk of the increased expense ratio is expected to flow through to the distribution – meaning the wealth industry, but not necessarily across the board.

SEBI has specifically earmarked 30 bps of the increase only for funds that get inflows from smaller cities and towns. Hence, only larger groups and smaller IFAs based in the smaller towns will get the increased commissions.

Rajiv Anand, managing director and CEO of Axis AMC, is happy about this: "I think appropriate incentivisation of the distribution community is absolutely essential. Equally increasing the longevity of assets is as important. I think the changes in regulations address both issues. Further for distributors in locations outside the top 15 cities, selling mutual funds has become a very attractive proposition and I think we will see increased flows from these areas in times to come."

But not everything in the SEBI announcement led to cheer. SEBI has asked the asset management industry to collapse the institutional and retail versions of their funds into one, again with just a few weeks' notice.

The move will effectively mean cross-subsidisation – if AMCs keep institutional pricing for liquid and debt funds, retail investors will also get the lower prices. But the bombshell was SEBI's direction for AMCs to launch "direct" plans for investors who approach the AMC directly rather than through an intermediary.

The wealth industry has been up in arms about the direct plan.

AMFI's Sinor doesn't believe it will lead to a big change. "The idea was slightly different – the idea was to give an option to the investor.

The whole discussion came around from the insurance industry, which offers online option at a lower cost.

So the discussion was why mutual funds couldn't do the same…. We also have a younger generation now who would like to use technology. Maybe they want to use for lower cost. My personal view is that only a small percentage of people will go direct."

FORMING ASSOCIATIONS

Prompted by the regulatory changes in the last 12 months, the wealth management industry appears to have realised that it needs to appear united when dealing with regulators, the product providers and also the media. Unlike other IFA associations aimed at peer sharing, the latest round of industry associations appear to have a broader agenda including getting a seat at the table in regulator consultations, collective bargaining with product and service providers such as training providers, and managing media perception.

As individuals, IFAs have long realised that they need to network in the industry. Even in a young industry, as India is, IFAs have formed regional associations some time ago, driven primarily by the need for peer sharing. Regional associations of IFAs such as IFA Galaxy and ASK Circle have been organising networking sessions and conferences to cater to this need.

However, when the Foundation of Independent Financial Advisors (FIFA) was set up in February 2012 as a non-profit organisation, it appeared to have a broader agenda of dealing with the wave of regulatory changes affecting the industry.

Its website mentions its objectives as "a common platform to proactively interact with the policy makers and to educate and empower the members to render proper service to the ever-growing investor class in India".

Dhruv Mehta, chairman at FIFA, was invited to attend consultation meetings with the Ministry of Finance to discuss the low penetration of mutual funds, particularly in smaller cities. He stresses that FIFA was the only representative of the "distribution community" as the other attendees were AMFI and CEOs of leading AMCs.

At a recent Hubbis roundtable, he mentioned that the meeting didn't even discuss the impact of the entry-load ban on the distribution community. "A lot of the regulations being implemented are a result of instances highlighted to the regulator," he says. "However, that is not necessarily representative of the practices of the industry at large. While distributors are important in growing business for the manufacturer, the key focus for the manufacturer's representation remains enhancing their business profitability. Hence it is essential that the distribution community make its own common and fair representation to the regulators."

The banks and national distributors were conspicuous by their absence in the consultation process with the finance ministry.

It's then that a few people got together to revive a move to set up an industry body. Neeraj Choksi and Jignesh Desai (see firm profile of NJ Group), along with Rajiv Bajaj (see firm profile of Bajaj Capital) and C Parthsarthy of Karvy (see firm profile of Karvy) re-ignited a non-profit company that was set up a few years ago. At a Hubbis roundtable in August 2012, Desai shared the idea of an "association open to all segments of distributors from domestic to foreign banks, national distributors, regional distributors, individual advisers, etc".

Named the Financial Intermediaries Association of India (FIAI), it stated its main aims as being the voice of intermediaries in regulatory consultations, to drive implementation of professional standards, and to build media profile for the advisory fraternity.

FIAI has made quite a bit of progress in recent months. The five founding members – Future Capital, Karvy, NJ Group, Bajaj Capital and ING – have already paid in their INR 5 lakh (approximately US$10,000) membership fee. A FIAI director, Rajiv Bajaj, says that "another 10 or so firms are actively considering it".

The founding firms are now dividing the membership drive amongst them to call larger IFAs and using forums such as the Hubbis roundtables to appeal to banks.

"The aim is to the top 20 largest institutions to consider membership," says Bajaj, explaining FIAI's focus on the larger firms first. "IFAs are a very important segment so we do want them to be members but to keep the organisation wieldy we have decided that it's best to take IFA associations as members. That way, smaller IFAs can organise themselves into local associations which can become regional chapters."

Addressing the concern about how different types of distributor firms could work together, Bajaj says: "While there may be different business models, the body could take up the 'common minimum programme' such as investor education, adviser professional standards, etc."

Another member of FIAI underlines what he says is the "need for a powerful trade body with sub-committees to focus on various product categories such as mutual funds and insurance to talk to regulators and product manufacturers as well as to do work for investor protection, investor education and self-discipline".

Realising the time required for driving membership, in mid-November 2012 FIAI appointed Gurpreet Singh as principal consultant.

Singh is already busy meeting potential members and collating point of view papers on: "Draft Investment Advisory Regulations, role of distributors in promoting schemes like Rajiv Gandhi Equity savings scheme, and the operational convenience for distributors in implementing new guidelines and products like New AMFI ARN card issue and Direct Plans."

Firm profile

FOREIGN BANK: RBS PRIVATE BANKING

The roots of the Royal Bank of Scotland date back to 1727 when King George I approved a royal charter. Today the RBS Group serves over 30 million customers in over 30 countries.

The wealth division of RBS group traces its private banking origins as far back as 1692. This was when Coutts & Co, the quintessential British private bank, opened for business in London.

In India, however, the wealth business is known as RBS Private Banking.

RBS entered the Indian private banking industry through its worldwide acquisition of ABN AMRO Bank in 2007.

Managing director Shiv Gupta, who has been a part of the RBS group for 11 years, relocated from Singapore to reposition the business in line with the Coutts' global private banking philosophy and approach.

Gupta's approach is essentially to take the best of current industry practice and apply it locally.

"To have an effective onshore Indian business you have to put extensive effort into ensuring a number of things," he explains. "You have to make sure that you are giving the client an exemplary level of service. You have to make sure you have a comprehensive product suite. And you have to do it all within the backdrop of India's domestic licensing and regulatory framework."

> "We make sure we keep a sharp focus on the experience the client gets whenever he is in contact with us or our bankers."

In India, RBS has put significant effort into building a wealth platform around four pillars: banking, investment services, wealth planning, and credit services.

Although many in the industry talk about key differentiators, Gupta again stresses the importance of basics.

RBS Private Banking also recently launched lending and wealth planning services.

Shiv Gupta
RBS Private Banking

"We make sure we keep a sharp focus on the experience the client gets whenever he is in contact with us or our bankers. We make sure our staff are very well trained, and we make sure that our products are of extremely high quality," Gupta says.

On the last point, one of the first things Gupta did when appointed in 2008 was to reconfigure RBS' investment service model with a multi-asset class "advisory tailored portfolio management service" and an "active advisory service".

The important difference is that both services are underlined by Coutts' investment philosophy -- and approach – while employing external partners for, say, fund selection.

Says Prateek Pant, director, products, about the approach: "We are firm believers in research that closely looks at future societal and industry trends as opposed to evaluating investments based on the conventional investment ratios such as price/earnings, price-to-book and dividend yield."

Adds Pant: "We believe this is a competitive advantage in an industry that is still largely reliant on fund selection using past financial analysis."

Over the past couple of years, the firm has grown to around 95 staff in four locations, including 30 relationship managers (RMs).

And Gupta believes the business has one of the most robust specialist support capabilities in the market. This includes investment advisers, market specialists, wealth planners and credit specialists.

"To deepen client engagement and to ensure better delivery of advice, we have investment advisers working alongside RMs in all of our locations," adds Gupta.

RBS Private Banking also recently launched lending and wealth planning services, giving further weight to Gupta's initial assertion about the necessity of a wide-ranging product suite.

"When people talk about a comprehensive product proposition, they are ultimately referring to the importance of being able to address a very wide range of client financial needs," he explains. "For that, you have to have a very deep tool box to take care of the needs of a typical high net worth client. Our toolbox is reflected in our four pillars."

RBS Private Banking has built its services around a segmentation strategy that requires clients to maintain GBP 1 million in investable assets with the bank.

Entrepreneurs form the majority of the firm's client base, although this skew is coincidental rather than the result of an active bias.

When using the firm's investment services – which include advice, execution and custody – clients can choose between a transaction-fee and advisory-fee based model.

The advisory-fee based model has proven particularly popular and RBS Private Banking has seen healthy growth in the level of client assets using that category.

"In the long run, the industry needs credible fee-based models and the growth that we have witnessed in advisory fee-based services is proof of the concept," says Gupta.

RBS Private Banking's also has a specific approach to the way that it searches, grooms and retains members of staff who directly service clients.

"We don't only look for large-standing books," says Gupta. "We also take a close look at experience and professional attributes - some of which are inherent and others that we believe can be developed."

Prateek Pant
RBS Private Banking

> "We are firm believers in research that closely looks at future societal and industry trends as opposed to evaluating investments based on the conventional investment ratios such as price/earnings, price-to-book and dividend yield."

Gupta adds that RBS Private Banking has made a considerable investment in training and development over the past 12 to 18 months.

He believes it is a strategic imperative for the industry, underscored by the launch of the RBS Private Banking global "Learning Journey" programme, customised for India.

It provides a framework for developing bankers, RMs, investment advisers and functional staff in necessary areas of technical expertise as well as in acquiring personal effectiveness skills.

In relation to his outlook on the wider Indian market, Gupta adds: "We believe that the Indian structural economic growth story is intact. The demographics are extremely favourable and we expect the pace of wealth creation to continue at an elevated rate. Our investments in the business are now beginning to pay off. We are optimistic about our prospects - and we are here for long-term."

FOREIGN BANK: SARASIN-ALPEN

Sarasin is a niche private bank established in 1841. It operates along with its investment banking associate, Alpen Capital, in India and the Middle East, to provide value-added solutions to clients.

"Sarasin is one of the oldest Swiss private banks – even older than UBS," exclaims Shiv Khazanchi, when asked about who Sarasin is.

Sarasin-Alpen set up its Indian operations in 2009, with Khazanchi relocating from London to Delhi to take up the chief executive role for both the private and investment banking operations in 2010.

Khazanchi's career spans 35 years across corporate, retail and private banking in banks like Grindlays and American Express, both in India and the UK. His most recent position before Sarasin-Alpen was managing director, global head of Indian business at Standard Chartered Private Bank.

"The private banking-investment banking model has worked really well for us. The firm's typical client relationship starts with investment banking, M&A, capital raising and joint venture," says Khazanchi.

"Once some of the wealth is unlocked, Sarasin-Alpen's small team of experienced private bankers helps clients with investment advice. "The track record already established in a short time-frame in a new venture like ours is truly impressive," he adds.

Leveraging its Gulf connection, Sarasin-Alpen has carved out a niche serving the Dubai-Mumbai corridor and it con-

Shiv Khazanchi

Sarasin-Alpen

tinues to see opportunities in this area. The focus is on Indian entrepreneurs looking to expand in the GCC region, or Middle Eastern businessmen wanting to establish a foothold in India.

Some landmark deals have already been accomplished, with the market soon to hear about more transactions.

The average portfolio size for Sarasin-Alpen reflects the firm's client segmentation strategy; similar to that of other investment banks' wealth businesses.

As is the team size of five senior relationship managers spread across the two offices, in Delhi and Mumbai.

Khazanchi is open about his talent strategy. He believes an existing book helps the individual to have a ready start, and at the same time, gives the firm access to an existing stream of revenue. However, he believes the "quasi investment banker / private banker" role might be a differentiator to attract talent.

Jignesh Shah
Sarasin-Alpen

> "The bank follows a structured approach to asset allocation as an investment philosophy, and its product offering follows an open architecture model covering mutual funds, equity and fixed income, structured products, PMS and alternative investments."

Khazanchi says he aims to integrate the bank's services of investment banking, wealth and trust and fiduciary services into a "high-end multi-family office."

The bank is also considering providing real estate advisory services in partnership with external consultants.

In the meantime, he is focusing on building an advisory service culture – given that significant part of private banking revenues already come from fee income.

The bank follows a structured approach to asset allocation as an investment philosophy, and its product offering follows an open architecture model covering mutual funds, equity and fixed income, structured products, PMS and alternative investments.

"We tend to position ourselves as a family office adviser," adds Jignesh Shah, executive director, investments. "In this process, we engage with all our service providers on a periodic basis with constructive feedback for constant improvement in our offering to our clients." ■

Q&A

POSITIONING FOR SUCCESS IN INDIA'S SHIFTING LANDSCAPE

Against the backdrop of the many opportunities and challenges for the industry, Stephane Honig, head of Indian markets at BNP Paribas Wealth Management, explains what is required to be successful in this environment.

What are the main opportunities for the Indian wealth management market?

I see three main opportunities: first, economic growth leading to wealth expansion; secondly, unlocking of wealth due to enhanced capital market environment; and thirdly, inter-generational transfer of wealth.

So what are the main challenges?

I see four main challenges for our industry in India.

First, India's laws and regulations are constantly evolving. This will require strong agility in platform adaptation from offer, compliance and marketing perspectives.

The second challenge is the level of client apprehension in investing in volatile markets. The crisis the financial world has gone through has shown to clients how critical it is to have an experienced and reliable relationship manager (RM) to help weather market crises and challenges.

Thirdly, investors are becoming price sensitive, which has imposed challenges for wealth managers to stay profitable and sustainable.

Lastly, it is a challenge to hire talent in such a competitive market while this is a pre-requisite to build client trust and attain profitability in this business. Our ability to train and grow our talent will be a key success factor for us in the coming years.

What are your views on how the industry will develop in the next three to five years? Who will be the winners and losers, and why?

I think the critical mass will have to be reached to ensure sustainability. Today most of the assets of high net worth and ultra high net worth individuals remain parked in retail and commercial banks. To convince our clients we need to build their trust by increasing our level of engagement and providing value.

Reaching the critical mass is both a quantitative and qualitative challenge. Given the size of the market and the different growth rates of each market segment, I think each player will have to determine its target client segment and develop a compelling value proposition to create a competitive edge. Another key requirement is having the right profile of bankers with relevant skills. The purpose is to be able to meet our clients' fast growing expectations and their level of sophistication.

In terms of who may be the winners and the losers, I believe it depends on each player's strategy and implementation quality. At BNP Paribas Wealth Management, we focus on quality of services, consistency of delivery, transparency in dealing and power of brand to drive for success.

How can you take advantage of the opportunities yet balance the need for a more cautious approach given the market volatility and regulatory crackdowns?

We have been working over the last 12 months to define how BNP Paribas Wealth Management can benefit from the global trends and the local opportunities.

First of all it's important to define and strengthen our foundations: BNP Paribas Wealth Management is an international player; the BNP Paribas Group has had a presence in India for more than 150 years; and in India, operating under the entity of BNP Paribas SA India Branch as well as BNP Paribas Investment Services India Pvt Ltd, we have been one of the pioneers in the India wealth management landscape with more than a decade of local experience.

We constantly expand and enhance our platform to meet the current and emerging needs of our target client segment relating to investments, credit, trust and estate planning, and international products. This is taking place together with the development of quality and number of our RMs in the market.

External factors like the capital market situation and the regulatory evolution have to be taken into consideration as well. We closely monitor the industry, market and regulatory evolutions, define clearly our positioning and focus on delivering value proposition to clients to further grow our business. BNP Paribas Wealth Management is well recognised by clients and peers. We have been ranked as one of the top 3 wealth managers by Asiamoney Private Banking Poll in recent years and we want to continue to build on this basis. We have strong ambitions for India and we are very committed to our India onshore business.

Stephane Honig
BNP Paribas Wealth Management

> "In terms of who may be the winners and the losers, I believe it depends on each player's strategy and implementation quality."

If you think about how to improve the industry in India, what would be your suggestions?

I have two suggestions to share. My first is to build a training institution owned and managed by industry players. This centre will pass on relevant technical skills to industry practitioners in an effective manner. With the help of the regulator, the institution will define industry standards, produce examinations and establish grading systems, and ensure bankers are properly trained and licensed before practising in the industry.

My second suggestion is to strengthen the suitability regulation by applying best practices of other jurisdictions like Singapore, taking into consideration net worth and market knowledge of the clients. ■

PRIVATE WEALTH: KOTAK WEALTH MANAGEMENT

With more than 14 years of experience, the wealth management business of Kotak Mahindra Bank is one of the most respected in the industry.

> "Kotak's family office services, cater to the needs of the ultra high net worth families. In addition to the investment services, the firm provides comprehensive solutions for preserving and transferring family wealth and legacy."

The group's private bank and family office divisions, headed by Jaideep Hansraj, manage the wealth for over 30% of India's top-100 families, ranging from entrepreneurs to families, as well as employed professionals.

In line with its belief that no single asset class tends to perform consistently over a long period of time, and therefore high net worth individuals (HNIs) need access to various asset classes, investment styles, themes and tenure – the Kotak group has built a formidable suite of products and services straddling this spectrum.

In terms of service offer, Kotak offers clients a choice of a transaction-based approach or an asset advisory approach.

The asset advisory approach of the firm allows the adviser to plan a portfolio while ensuring complete alignment of interest with the client.

Through the Kotak Mahindra Group companies, the client has access to various asset classes like equity, debt, private equity, real estate funds, structured products, insurance, quasi private equity, mutual funds, etc.

These could be in a mix of investment styles like discretionary and non-discretionary equity, concentrated portfolios, In line with its belief that no single asset class tends to perform consistently over a long period of time, and therefore high net worth individuals (HNIs) need access to various asset classes, investment styles, themes and tenure – the Kotak group has built a formidable suite of products and services straddling this spectrum.

Ashish Khetan

Kotak Mahindra Bank

diversified portfolios, long only, conservative hedged, arbitrage, growth, value, etc.

Given that these and other products need to be tailored and specific, most of these are structured in-house.

Other examples of product innovation using in-house companies include institutional family office services, a dedicated structured products desk, a dedicated estate planning desk, closed-ended portfolio management structures, dedicated alternate asset solutions, index-linked products, real estate funds for non-institutional customers, as well as customised structures for clients.

Kotak's family office services, headed by Ashish Khetan, cater to the needs of the ultra high net worth families.

In addition to the investment services, the firm provides comprehensive solutions for preserving and transferring family wealth and legacy.

Kotak Mahindra Trusteeship Services Limited (KMTSL) is a 100%-owned subsidiary of Kotak Mahindra Bank Limited.

It offers estate planning services which include advisory services, drafting and execution services, trusteeship services, custody services and executorship services. ■

Feature article

PRODUCT TRENDS

Depending on whom you speak to, the Indian market has too many products or not enough. However, the sophistication of the market is not measured by the number of products but by the diversity for diversification and return-maximisation purposes.

Investors need to be able to diversify appropriately, for which they require access to different asset classes that have low correlations with each other. Investors should also be able to maximise their returns.

The table shows the availability of products in the Indian market across asset classes and structures. While it appears the product universe covers all asset classes, closer inspection reveals gaps.

	Direct	Managed	Pooled	Structured
Cash	Bank deposit Small savings	Discretionary mandates	Mutual funds – liquid	Dual currency deposits
Fixed income	Tax free bonds Company deposits Corporate bonds	PMS	Mutual funds	Instruments issued by NBFCs
Real estate	Freehold real estate	-	AIF – real estate	Mezzanine debt contracts with real estate developers
Equities	Listed shares Direct private/venture equity Angel investments	PMS Discretionary mandates with brokers or wealth firms	Mutual funds – diversified, sectoral, intl ETFs AIF – Private/venture equity, hedge funds	Products issued by NBFCs or investment banks
Commodities	Precious metal bars/coins, jewelry	Discretionary mandates	AIF – hedge funds Mutual funds - commodity stocks ETFs	Products issued by NBFCs or investment banks

For example, investors can invest in real estate either directly or now through the AIF route, both of which require high minimum investment amounts. Hence retail investors with smaller investable assets miss out on the returns available from this pretty significant asset class.

This chapter looks at the product trends in each category.

BANK DEPOSITS AND SMALL SAVINGS

A big proportion of Indian house-hold savings are held in bank deposits.

In October 2011, the Reserve Bank of India (RBI) announced the deregulation of savings bank deposit rates.

This means banks are now free to determine the interest rates paid on savings accounts unlike the fixed rate of 4% previously.

A number of small- to mid-sized banks have taken advantage of this opportunity and started advertising savings deposit rates of up to 7% and term deposit rates of up to 9%.

Investors also have access to numerous "small savings" products offered by the government.

Over the past few years, there have been minor tweaks in the small savings segment.

The Kisan Vikas Patra (translated as Farmer growth certificate) was discontinued in December 2011. On the other hand, the Infrastructure Bonds introduced in the 2010 budget have proven to be very popular.

The major development was the government's launch of the New Pension System (NPS) in 2009. Aimed at the "unorganised" or non-salaried segment of the working population, the NPS is essentially an online "central record-keeping agency" which allows the investor to set up a permanent retirement account. Investors can choose the asset allocation amongst the three asset classes available – equities (indexed to the popular indices tracking the top 30 or 50 stocks), government bonds or corporate bonds. They can also choose the provider amongst the six pension fund managers.

The interesting feature of the NPS design is the "auto choice". If investors don't choose the asset allocation, their funds are automatically split into the three asset classes based on their

Bank deposits and small savings

	Term	Return/Risk
Post office term deposit	1-5 yr term deposits but can borrow against or withdraw prematurely	Interest rates declared annually in line with govt bonds of similar maturity with spread of 0.25%; risk-free
Employee Provident Fund aimed at salaried for accumulation of retirement savings; tax concessions	Lock-in period of 15 years, can be extended for another 5 years after lock-in period is over, can borrow loans from it. Prmature withdrawal not permissable	Interest rates declared annually; risk-free
Public Provident Fund – aimed at self-employed for accumulation of retirement savings; tax concessions	15 yr lock-in but can borrow against and withdraw on some conditions	Interest rates declared annually in line with Govt bonds of similar maturity with spread of 0.25%; risk-free
National Savings Certificates	5 and 10yr terms	Interest rates compounded half yearly in line with Govt bonds of similar maturity with spread of 0.25 and 0.5% on 5 and 10yr terms; risk-free
Senior Citizen Saving Scheme – aimed at retirees	5 yrs which can be extended by 3yrs	Interest rates declared annually in line with Govt bonds of similar maturity with spread of 1%; risk-free
Post Office Monthly Income Scheme	5 yrs but can withdraw on some conditions	Interest rates declared annually in line with Govt bonds of similar maturity with spread of 0.25%; risk-free
Infrastructure Bonds introduced in 2010 with tax concessions	10 yrs; can borrow against or trade in secondary market after 5 yrs	Interest rate varies across issuers and terms; carries credit ratings; bonds prices fluctuate with prevailing interest rates
RBI Savings Bonds (Govt of India Bonds)	6 yrs but can borrow against	Currently 8%; risk-free as guaranteed by Govt of India
Capital Gains Tax Exemption Bonds or 54EC Bonds can only be purchased with long term capital gains on residential real estate	3 yrs	6% payable annually; risk free
New Pension System – aimed at self-employed for accumulation of retirement savings; tax concessions	Tier I until age 60 after which 40% will have to buy annuities Tier II is liquid	Choice of 3 asset classes equities, Govt bonds and corporate bonds – managed by selected managers; returns in line with market; equities is managed passively while bonds are managed actively; also has auto-choice where asset allocation is based on investor's age

Source: Value Research Savings & Investment Yearbook 2012

Arvind Bansal

ING Investment Management

"By offering a multi-asset, multi-manager product to clients.... IFAs can invest their time in growing their business"

Since the insurance industry had a good distribution network, with good sales commissions, the insurance product category is significant in the households savings break-up, ahead of the other, better investment options.

The table shows the main types of products available, including whether they are primarily insurance or investment products.

A significant share of savings has been invested in traditional endowment

age. Every year the asset allocation changes such that it is the most aggressive when investors are younger and becomes most conservative when they reach retirement age. So the design incorporates the concept of a lifecycle fund.

INSURANCE PRODUCTS

India's insurance premium income to GDP ratio of 4.6% is lower than developed markets but, interestingly, higher than China, and the US.

However, insurance industry reports suggest that this figure is inflated by the higher savings component embedded in premium figures.

The Indian market, similar to other markets in earlier stages of development, tends to buy insurance not just as insurance but as a savings / investment product. This reflects the "value for money" mentality – they want to get their money back in case the insured life survives the term. This premium income is then channeled into equity and debt markets through unit-linked products.

Insurance products

Products	Product structure	Primary aim	Investment component
Whole of life/endowment	Contract designed to pay lump sum on maturity (typically 10 - 20 yr terms) or death/critical illness. Has surrender value if cashed in earlier.	Combination of insurance and investment	Managed by insurance co's statutory funds. May declare regular 'reversionary bonuses' and a final 'terminal bonus' in addition to the sum assured.
Child plan	Contract designed to pay lump sum on death of parent before maturity (when child turns 18). Has cash value if parent survives term.	Combination of insurance and investment	Managed by insurance co's statutory funds. There are investment option -linked child plans that are essentially ULIPS
Pension plan	Savings plan designed to accumulate and invest regular payments to form a lump sum at retirement , which can be converted to a monthly pension (annuity)	Investment	
Term plan	Contract designed to pay lump sum on death before maturity. No cash value if insured survives term.	Insurance	None
Annuities	Contract designed to convert a regular payment or lump sum (immediate annuity) into regular pension. Different versions for no cash value at death before term, or some cash value at early death.	Investment. However life annuities offer longevity insurance.	Managed by insurance co's statut ory funds.
ULIPS	Contract designed to save and invest regular payment to form a lump sum at maturity. Small part of payments goes towards a term plan.	Investment	Investor chooses investment options, managed by insurance co
Health Insurance	Contract designed to pay for medical expenses associated with illness and injuries.	Insurance	Managed by insurance co's statutory funds

plans and ULIPs, which are, significantly or essentially, investment products. However, the regulatory framework for these is significantly different to other investment products. This led to a "turf war" between the regulators IRDA and SEBI when the latter declared that ULIPs should fall under SEBI's jurisdiction.

While the turf war ended through the intervention of the Finance Ministry, the insurance regulator announced a number of changes capping the commissions to one-third of previous levels. Demand also suffered with the increased lock-in period from three years to five years and the slide in the equity market.

Explaining the developments in the insurance market post 2008, Anand Pejawar, executive director, marketing, at SBI Life, says: "From January 2009 until September 2010, the entire ULIP product suite underwent complete change twice due to regulatory interventions and revisions of product norms. During this period the regulator allowed companies to come out with variable life insurance products. Life insurance companies also started coming out with a new generation of ULIP products with a minimum of 5 years' lock-in and the unique feature of NAV guaranteed."

Brokers' reports on insurance companies described the changes: "The insurance sector has gone through a bad patch for over two years, first due to the financial crisis which led to a significant correction in equity markets and therefore on the unit-linked plans, and then the regulatory changes, which forced companies to revisit their strategies and business models."

Adds Pejawar: "Because of the capping of charges on ULIPs, it is now the most regulated product in the world."

"The wealth industry can play a huge and pivotal role in insurance market."

Since then, the share of ULIPs in insurance inflows has dropped from near 90% to 15%. Not only did the absolute volume of business drop, the business mix changed towards traditional policies, which didn't have fee caps.

The insurance industry has also started focusing on other products like net asset value (NAV)-guaranteed products and term policies.

Says Pejawar: "Term has come back for two reasons. First, it is available online very cheaply. Now it's available at 40% to 50% cheaper online than what it was before. Secondly, wealth managers are also recommending term plans, such that the balance that would have otherwise gone to ULIPs could be invested into mutual funds."

In October 2012, Finance Minister P. Chidambaram foreshadowed further reforms by announcing a partial roadmap for insurance liberalisation including speedier clearance of products, fewer restrictions on distribution, tax benefits for individuals who take insurance cover, and the channeling of more insurance money into infrastructure projects.

Going forward, Pejawar says he expects further changes in the product line-up. He believes the regulator should ask insurers to withdraw NAV-guaranteed products, so insurers may go back to ULIPs or focus on variable insurance. Universal life insurance plans have still not entered the market, and may be seen as a replacement to NAV-guaranteed products.

Radhika Gupta
Forefront Capital

"What is critical to the development of the hedge fund industry is a strong ecosystem"

Mutual funds

Morningstar category	Benchmark	Description
Equity Large cap	BSE 100	Primarily consist of stocks from the top 70% market capitalisation of the equity market. These funds invest at least 65% of total assets in Indian equities, and the balance can be invested in other asset classes such as fixed income, gold and overseas equities, among others.
Equity Small/Mid-Cap	CNX Mid Cap	Primarily consist of stocks from the bottom 30% market capitalisation of the equity market. These funds invest at least 65% of total assets in Indian equities, and the balance can be invested in other asset classes such as fixed income, gold and overseas equities, among others.
Equity Global Other	Not rated	That invest at least 35% of total assets in instruments issued by overseas i.e. non-Indian companies. In addition, funds that invest at least 35% of total assets in exchange traded funds, fund of funds domiciled outside India are also included in this category.
Equity Linked Saving Schemes	BSE 200	Notified as ELSS by SEBI under Section 10 (23D). Investments of up to Rs 100,000 in a financial year in these funds are exempt from Income Tax under Section 80C of the Income Tax Act, 1961. Investments in ELSS are subject to a lock-in of three years from the date of investment.
Sector–Energy, Financial services, FMCG, Healthcare, Precious metals, Technology, Other	BSE sector indices	Invest at least 65% of total assets in Indian equities and at least 50% of total assets in equities from the aforementioned industries.
Fixed Maturity Short term Bond		Have a fixed horizon of existence ranging from one to three years. They primarily invest in investment-grade fixed-income securities whose average effective maturities coincide with the investment horizon. Given their focus on instruments with a short duration, they offer low interest-rate sensitivity. They typically invest in debentures, government securities, call money, commercial papers and certificate of deposits, among others.
Fixed Maturity Ultrashort Bond		Have a fixed horizon of existence of up to one year. They primarily invest in investment-grade fixed-income securities whose average effective maturities coincide with the investment horizon. Given their focus on instruments with a short duration, they offer minimal interest-rate sensitivity. They typically invest in treasury bills, call money, commercial papers and certificate of deposits, among others.
Intermediate Bond		Invest in investment-grade fixed-income securities with average effective maturities ranging from three to seven years. Given their focus on instruments with a medium duration, they offer lower interest-rate sensitivity as compared to funds with longer durations, but are more sensitive to interest rate risk than Short-Term Bond funds. They typically invest in debentures, government securities; call money, commercial papers and certificate of deposits, among others.
Intermediate Government Bond	ICICI Securities Mibex	Invest in securities issued by the central government, state governments and government-backed entities. These funds have average effective maturities ranging from three to seven years. Given their focus on instruments with a medium duration, they offer lower interest-rate sensitivity as compared to funds with longer durations, but are more sensitive to interest rate risk than Short-Term Government Bond funds.
Long term Bond		Invest in investment-grade fixed-income securities with average effective maturities greater than seven years. Given their focus on instruments with longer durations, they are exposed to the highest interest rate risk. They typically invest in longer-dated debentures and government securities; call money, commercial papers and certificate of deposits, among others.
Long-term Government Bond	ICICI Securities Libex	Invest in securities issued by the central government, state governments and government-backed entities. These funds have average effective maturities greater than seven years. Given their focus on instruments with longer durations, they are exposed to the highest interest rate risk.
Short term Bond		Invest in investment-grade fixed-income securities with average effective maturities ranging from one to three years. Given their focus on instruments with a short duration, they offer lower interest-rate sensitivity as compared to funds with longer durations. They typically invest in debentures, government securities; call money, commercial papers and certificate of deposits, among others.
Short term Government Bond		Invest in securities issued by the central government, state governments and government-backed entities. These funds have average effective maturities of up to three years. Given their focus on instruments with a short duration, they offer lower interest-rate sensitivity as compared to other government bond fund categories

Ultrashort Bond		Invest in investment-grade fixed-income securities with average effective maturities of less than one year. Given their focus on instruments with a short duration, they offer low interest-rate sensitivity. They typically invest in treasury bills; call money, commercial papers and certificate of deposits, among others.
Money Market		Invest in investment-grade fixed-income securities with maturities of up to 91 days. Given their focus on instruments with a short duration, they offer minimal interest-rate sensitivity. They typically invest in treasury bills; call money, commercial papers and certificate of deposits, among others.
Arbitrage Funds		Pursue market-neutral strategies, whereby returns are not significantly impacted by market volatility. Typically, they buy equities in the cash market and simultaneously sell in the futures market, thus ensuring market neutrality.
Moderate allocation		Invest across multiple asset classes: equity, fixed income, cash and precious metal-exchange traded funds, among others; allocation to Indian equities usually ranges from 30%-75%
Conservative allocation		Invest across multiple asset classes: equity, fixed income, cash and precious metal-exchange traded funds, among others; allocation to Indian equities does not exceed 30%

Talking about the role of insurance products for the wealth management industry, Pejawar says: "The wealth industry can play a huge and pivotal role in insurance market. If you look at how many people even at that level understand life as a concept of insurance. Why should I buy and what level should I buy? Currently banks offer ULIPs to HNI and UHNI customers to meet cross-selling targets. But if somebody is in a position to do a correct 'needs analysis,' and find out his risk-taking ability including tenure of risk, then wealth management has a fantastic future as far as insurance products are concerned. A good wealth manager has all the information and the tools required to do this analysis and recommend the right solution."

The insurance industry also has products for HNIs and entrepreneurs, the target market for private banks.

Pejawar highlights key-man insurance as one example: "For an UHNI, say a businessman or industrialist, if you pull out any agreement by his bankers, one will see that all their past present and future assets are hypothecated/ linked to the bank. Tomorrow, God forbid, if something happens to the industry, nothing will be safe. If the banker wants to make life miserable, they can.

In spite of having a separate clause of issuing life insurance policies under the Married Womens Property Act, not many have taken the policies under the same. How many people in India have looked at key man insurance to cover their interest in business and ensure the same runs even if they are no more in the company to run it?"

Adds Pejawar: "My advice to wealth managers is if you want to do a reasonable job, you must first do a correct need's analysis. Only then can you recommend the right kind of insurance solution. Insurance could be any kind – term, investment, pension, child education – depending on the specific needs and requirements. One-size-fits all doesn't not work in life insurance."

MUTUAL FUNDS

There are about 2000 mutual fund products issued by about 45 asset

Anand Pejawar

SBI Life

"A good wealth manager has all the information and the tools required to do this analysis and recommend the right solution"

Dhruva Chatterji

Morningstar

"In my opinion there are too many products in the market"

management companies (AMCs). Rating houses classify them into more than 20 categories, across debt, equity and hybrid funds.

There are many practitioners who believe the number of products isn't necessary. "In my opinion there are too many products in the market," says Dhruva Raj Chatterji, senior research analyst, Morningstar India. "Also some of the funds have overlapping themes or do not have a well-defined investment universe, which further confuses investors. There has been some streamlining in recent times, with some fund companies merging similar schemes or redundant themes in their product basket, but there is still room for improvement."

One of the reasons for the plethora of funds was the popularity of new fund offers (NFOs) a few years ago.

Retail investors, who apparently lack the understanding of how mutual funds work, tended to prefer funds the "issue price" of NAVs. They think that once the NAV rises, like stock prices, they may have had their run.

AMCs would therefore announce NFOs quite regularly, launching funds that were very similar to their existing funds, just to take advantage of this investor preference.

They were helped by the fact that they could charge the higher marketing expenses of NFOs to the fund. Distributers also liked NFOs as they had an excuse to switch investors and collect up-front commissions.

However, SEBI has announced a number of changes in the last three to four years that has stopped this practice. For example, the marketing expenses charged to the fund were capped, and the AMCs had to justify how the new fund was different to existing funds.

The most significant change came in 2009 when it banned entry loads altogether. The number of new product launches has slowed significantly since then.

Indeed, the AMCs are being forced to rationalise their product portfolios. Funds, or schemes, would have multiple "plans" to cater to retail and institutional investors.

However, changes to mutual fund regulations announced in September 2012 mean that AMCs have to consolidate the number of plans into a single one per fund.

All these changes mean that product proliferation should come down. Hopefully it also means that the industry focuses on real product innovation.

Cash and fixed income

A significant portion of the assets in cash and fixed income funds are from institutional investors. This is partly driven by tax advantages offered by mutual funds.

Tax also drives investments from HNIs. Explains Arvind Bansal, head of multi-manager investments at ING Investment Management in India: "In the HNI segment, tax is a sensitive issue. So the investor looks for an efficient solution that can minimise its impact. In an actively managed debt portfolio, if transacted within a year, the HNI investor would have to pay 30% tax each time on the gains made. As long as a debt fund-of-funds does well, the taxation issue gets dropped and also there are indexation benefits on long-term redemptions of mutual fund units."

Hence, the debt funds in the ING multi-manager are marketed to the HNI segment.

A very popular product in the segment is peculiar to the Indian market: the Fixed Maturity Plan (FMP). FMP funds invest into bonds and hold them to maturity. Chatterji calls them "a game-changer for the fund industry".

Rising interest rates in 2010 and 2011 were conducive for FMPs and they registered robust inflows.

But the inflows peaked in March 2012, after which short-term interest rates have come down significantly, and inflows have withered.

In the recent past, the industry adapted this product category further for the HNI segment to launch hold-to-maturity products. AMCs such as DWS, JP Morgan, HDFC, Sundaram and ICICI launched products in this category.

Another innovation aimed at the HNI segment has been accruals on high-yielding bonds issued by the likes of Franklin Templeton and Reliance.

The vanilla "dynamic bond fund" category has also seen new launches and large inflows during 2012 as interest rates started dropping.

While the fixed income category is mostly marketed to institutional and HNI segments, one could also see an attempt to market at least the cash/liquid fund category to retail and affluent investors.

For instance, Reliance AMC launched a facility whereby corporate salary accounts could be directly linked to ultra short-term liquid (cash) mutual funds.

This means that investors don't lose interest on days it takes to usually receive the salary in a bank account and then transfer to a mutual fund. To ensure easy access, the AMC tied up with MasterCard's ATM card facilities.

Gold

Sundeep Sikka at Reliance is always looking for new ideas: "The innovations will keep coming. For example, we started the trend of gold ETF funds, where we came out with fund of fund beyond the ETF, and that changed the dynamics of that segment."

He was referring to a fund which in turn invests into listed gold ETFs making the gold asset class available to retail investors who did not have demat accounts. (Demat = dematerialised or non-paper shareholding accounts).

Equity

However, as the firm launches new products, Sikka is cautious about complexity. "There will be a lot of product innovation but [that] doesn't mean launching new and new exotic products," he says. "Indian investors see the sectoral products as diversified and they keep investing in it more than what is required, so my advice is that for next few years keep it simple."

There are many in the industry which support the need for simplicity.

Says HN Sinor of the Association of Mutual Funds in India, the apex body for mutual funds: "AMCs need to talk about simple products. I think index, diversified and something like FMP or money market mutual funds, are the only two or three products that need to be provided at the mass end. Sectoral funds should be completely out."

A category that should have appealed to retail investors' savings investment plans (SIPs) is multi-manager equity funds. However, pricing and tax disadvantages make them unattractive, according to Bansal of ING Investments.

"In a multi-manager structure, pricing remains an issue as the total of underlying fees plus the fund-of-funds fee cannot exceed 2.5%. So, to compete with a normal fund, in an ideal scenario, one needs to have institutional ie lower pricing options to succeed. Also, equity fund of funds are still treated like debt from a taxation perspective. This anomaly should go and the fund should be treated at par with equity funds from a tax perspective."

Sinor alludes to his preference for absolute basis to gain the trust of retail investors. "Investors feel short-changed when the product is not doing well. However much we say that the fund performance is down because the market goes down, the experts need to learn to foresee the market… which I don't see happening. They just float around with the market."

International funds

A number of AMCs have feeder funds that invest into overseas funds, giving local investors exposure to international equities. However, these have never been popular.

"A category that should have appealed to retail investors' savings investment plans (SIPs) is multi-manager equity funds. However, pricing and tax disadvantages make them unattractive."

Sailesh Haribhakti

DAR MentorCap

"The steady upswing in the Hindi film industry has now prepared it for systems, processes and good governance"

Advisers say their investors would rather stick to familiar territory but also argue that why they should invest in markets with lower growth.

For those who consider the diversification argument, the worry becomes the currency – they believe the Indian rupee's depreciation will reverse.

Adds Chatterji: "A few global funds have also been launched, but they have not mobilised much money."

Solution-oriented funds

For the mass retail segment, there is an argument for simple yet multi-asset class products.

While a prime example of the lifecycle concept, the NPS has not proven to be popular; though some industry players are inspired by it.

"Household savings in India are dominated by savings in fixed deposits. The other large components are real estate and gold. Equities comprise about 5%. This asset allocation clearly shows that the Indian investor is by and large risk averse. Therefore, we need to focus managing risk or volatility in our mutual fund products," says Anand of Axis AMC.

The firm launched the Axis Triple Advantage Fund in 2010, which provides roughly equal exposure to equities, debt and gold, with the idea of managing volatility through diversification across asset classes. Anand explains that the manager "manages volatility through a quantitative asset allocation model. The aim is to manage volatility in these products in the short term and beat inflation in the long term."

So far the fund has met its objectives delivering 24% since inception. "On a six-month rolling basis it has thus far not delivered negative returns as well. The fund is therefore meeting its objective, managing volatility in the short term and beating inflation in the long term," says Anand.

Franklin Templeton also has a dynamic asset allocation fund which tilts the asset allocation towards equities or debt based on the manager's views on valuations. Sinor advises the asset management industry to consider launching products "something like a simple retirement plan with a tax break in mutual funds. You could have age profile or risk profile integrated into it. This is where the investor himself gets a tax break in return for locking money in until retirement age."

One could argue if the tax breaks are necessary if the product is aimed at the low-income segment. But Sachdev will pursue them anyway: "We don't have pension tax benefits right now but we plan to apply for them. "

While such solution-oriented funds are being aimed at the mass segment, the broader wealth management industry, which focuses on the affluent and HNI segments, does not like the idea. An IFA summed up the sentiment: "Solution should be provided by the adviser as he can customise the product."

Sikka also believes that solution-oriented funds would add unnecessary complexity.

"Broadly I believe that the mantra is keep its straight and simple, as Indian investors are not yet ready for the very mature or specific products."

Bansal points out that multi-asset class funds are well-suited to retail investors, and multi-manager funds are even more effective in helping to diversify small investment amounts.

"A multi-asset multi-manager also benefits the IFA who currently doesn't have a cost-efficient and tax-efficient solution to actively manage asset allocation and fund selection for his clients. By offering a multi-asset multi-manager product to clients for simplified investing, the IFA can then invest his time in increasing his business," he says.

Real estate

When asked about gaps in the product universe, the wealth management industry always mentions real estate. While it has worked out ways to structure products for the HNI segment and now has access to AIF funds (see the next section), the industry has been waiting for real estate mutual funds.

The regulations for real estate mutual funds were issued a couple of years ago but there haven't been any takers amongst the product issuers.

Until now. Peerless AMC, a Kolkata-based asset manager, is believed to be putting together India's first real estate mutual fund in partnership with consulting firm Jones Lang LaSalle.

Portfolio management services

Investors can also access professional management in listed markets through more than 250 Portfolio Management Service (PMS) providers registered with SEBI. PMS is essentially a managed account service.

The PMS structure provides an alternative to mutual funds for investors who wish to give discretion to a professional to manage their equity or fixed income portfolios. While supposedly aimed at the HNI segment, the low minimum investment amount of INR 5 lakhs (US$10,000) meant that the products were being marketed to the affluent segment as well.

With low barriers to entry for both the provider and the investor, a number of mis-selling cases were reported.

SEBI responded with changes to the PMS regulations in early 2012. The main changes were the increase in the minimum investment amount to INR 1 crore (US$200,000). In addition, the asset classes were limited to listed assets. Product providers in the real estate and alternatives space had to go for separate registration under the AIF regulations (see the next section).

In line with other markets in which products aimed at the HNI segment are not as tightly regulated as those aimed at retail investors, the PMS providers have much more flexibility in terms of portfolio management, fees and reporting.

Alternative investments

	Category I	Category II	Category III
SEBI categorisation	Invests into sectors that gets govt support such as venture, SME, social or infrastructure	Does not fally in cat I or III and does not undertake leverage	May employ diverse or complex trading strategies, and may employ leverage
Likely types of funds	Venture capital Infrastructure	Private equity/debt, Real estate	Hedge funds
SEBI approved funds as at November 7, 2012	IFCI Syncamore India Infrastructure Fund Utthishta Yekum Fund (VC) Indiaquotient Investment Trust (VC) IL&FS Dicci Trust (SME) Dar MentorCap Film Fund	IL&FS Excedo Realty Fund IL&FS Sabre Partners Trust and KKR India Alternate Credit Opportunities Fund IL&FS Real Estate Opportunities Trust	Forefront Alternate Investment Trust

Outlining why his group's product platform increasingly has managed products, Hrishikesh Parandekar of Karvy Group says: "Clients are looking at managed equity products and not just the conventional types.... There is also a lot of interest on doing equity on an advisory basis or non-discretionary basis, not packaged-product basis."

ALTERNATIVE INVESTMENTS

SEBI issued its AIF guidelines in May 2012 for regulating funds in any asset class not covered by mutual funds and PMS regulations. The guidelines specify minimum investment amounts, sponsor investment, etc.

The guidelines offer three categories for registration:

- Category I – funds that invest in sectors that the government considers as having positive social impact such as venture capital, SME, infrastructure
- Category II – funds that do not fall into categories I or III, and do not undertake leverage; this category covers private equity and debt, and real estate
- Category III – funds that employ diverse or complex trading strategies, and may employ leverage, such as hedge funds

As we went to print, news reports announced that a number of additional funds had received SEBI approval. While real estate and private equity funds are relatively well understood (since they were available in PMS form earlier), it is worthwhile highlighting some funds that will offer exposure to newer asset classes such as hedge funds, private debt and films.

HEDGE FUNDS

The only fund to receive approval under category III is the Forefront one. Says Radhika Gupta, director at Forefront Capital: "Hedge funds come at a very interesting time for our markets. Traditionally, long-only equity funds have tested investors' patience because the equity index itself has been flat in the last five years. For many investors, the five-year return on long only funds has been flat or sub-inflation, making absolute return has a concept the need of the hour."

> The market for structured products in India is not as developed as in other financial centres.

While Gupta is thrilled to receive the first license, being the only fund in a category has its own challenges. "What is critical to the development of the hedge fund industry is a strong ecosystem – wealth managers who can educate clients about the asset class, tax and legal counsel who can provide the right guidance, and custodians/ administrators who have the ability to manage hedge fund operations. Most importantly, managers need to focus on two facets: investor education and risk management. Hedge funds are less about returns, as they are about risk management – a few initial funds doing badly because of poor risk management will take the industry back five years. The right clients should invest, and know what they invest in."

The Forefront fund is diversified absolute return – long-short and arbitrage – with equity returns and risk between equity and fixed income. Gupta hopes "it will be of one many funds that India will see".

Film funds

Many people lump film and art funds together as exotic investments, and have a philosophical view on whether they should form part of investment portfolios. However, there is a major difference. Films have more predictable cash flows than art. Indeed, film studios are perfectly legitimate businesses, some of which are public stocks. On the other hand, one is hard pressed to find art businesses on the stock market, although there are also ancillary businesses such as art auction houses.

In India, informal film financing has given way to formal routes including bank loans, studios and film funds.

Some film funds were launched in the bull-market leading up to 2008 but have since all but disappeared. But they appear to be making a comeback with the launch of DAR MentorCap, being the only one to have received SEBI approval under the new AIF guidelines so far.

DAR MentorCap is a joint venture between a film production, a distribution company and an investment advisory firm. The closed-ended fund is targeting an IRR in excess of 20% over the term of five years.

Says DAR MentorCap founder Shailesh Haribhakti: "The steady upswing in the Hindi film industry has now prepared it for systems, processes and good governance. The simultaneous establishment of the AIF regulations has created the space for this unique film fund that will execute over 20 projects in the next two to three years."

STRUCTURED PRODUCTS

A structured product is an umbrella term for any product that packages an investment strategy rather than giving direct access to the underlying asset class or security.

Usually, structured products do some "financial engineering" to package a combination of securities and derivatives to achieve a pre-set payoff, or outcome. They usually include capital protection but not always. Since they usually involve complex strategies, they are marketed to HNIs and institutional investors.

The market for structured products in India is not as developed as in other financial centres.

Some six to seven investment banks and NBFCs issued structured products, including Citibank, Macquarie, RBS, and Reliance Capital. According to Finance Asia, the volumes grew from about US$300 million in 2006/07 to US$1 billion in 2008/09.

While the market for pre-packaged structured products issued by investment banks appears to have dried up in the past 12 to 18 months, the wealth industry has been structuring custom contracts to achieve pre-set outcomes, essentially mimicking structured products.

"People are willing to go beyond bank fixed deposits and are looking for more high-yielding forms of debts like corporate fixed deposit and, more interestingly, real estate-backed, higher-yielding varieties," explains Parandekar. ■

Co-published with Axis Mutual Fund

INVESTING FOR A VOLATILE WORLD

In conversations with investors, one topic keeps coming up: with all the volatility in the markets, in which asset class should one invest?

Volatility is core to the functioning of financial markets and it is important to look at how one can survive volatility, asking the question: is it possible to use volatility to our advantage in investing?

The year 2011 was a volatile one for the various asset markets. The table called "Performance of asset classes in 2011" shows the movement in equities, bonds and gold during the year along with the downside and upside seen intra-year.

There was a lot of volatility during the year, with the intra-year returns being more than the annual return. This highlights the potential risk in short-term timing, as well as the potential gain. Equities which had the worst performance overall, had an intra-year gains of over 13%, while gold which performed best, had an intra-year sell off of over 10%.

The year 2011 saw gold shining as it was the best-performing asset. Equities had a poor year in contrast.

Performance of asset classes in 2011

	Equity (Nifty)	Bonds (I Sec Sovereign Bond Index)	Gold (in Rupees)
Returns for the year (%)	-24.6	6.3	31.3
Maximum drawdown (peak - to - trough returns, %)	-26.2	-2.8	-10.2
Maximum run up (trough to peak returns, %)	13.1	8.2	52.3

Performance of asset classes in 2011

Table 2 - Returns from asset classes				
Year	Stocks	Bonds	Gold	Average
1995	- 23%	3%	14%	- 2%
1996	- 1%	13%	- 3%	3%
1997	20%	24%	- 14%	10%
1998	- 18%	8%	8%	0%
1999	67%	16%	2%	29%
2000	- 15%	13%	1%	0%
2001	- 16%	25%	6%	5%
2002	3%	23%	24%	17%
2003	72%	12%	13%	33%
2004	11%	- 1%	1%	3%
2005	36%	6%	22%	22%
2006	40%	6%	21%	22%
2007	55%	7%	17%	26%
2008	- 52%	27%	31%	2%
2009	76%	- 6%	19%	30%
2010	18%	6%	24%	16%
2011	- 25%	6%	31%	4%

A look back in history suggests that the same asset class does not do well across all time periods. Indeed, there is quite a bit of change-around as the best performer in one period may be the worst in the next.

THE MAGIC OF DIVERSIFICATION

What is interesting is that in most years, two out of three asset classes have delivered positive returns (16 out of 17 years in the table called "Returns from asset classes"). Only once have two asset classes been negative at the same time.

It is also interesting to see that the average return (assuming investors held equal amounts of the three assets during the year) would have been positive in all but one year.

How does this happen?

Volatility is inherent to investing. Reduction in volatility can be done in two ways: invest in a less-risky asset (potentially with lower returns) or diversify to reduce risk.

Diversification works because it is impossible to predict which asset will do well in the future, making it imperative to hold some of each asset class to benefit from future performance. At the same time, diversification ensures that even if one asset class performs badly, the overall portfolio retains a measure of stability.

The table shows that even in a year like 2008, a diversified portfolio across the three assets held its value.

REBALANCING - THE ASSET ALLOCATION SECRET NO-ONE TALKS ABOUT

The second way to take advantage of market volatility is to rebalance the investment portfolio.

As the various assets perform differently over time, the portfolio allocation changes across the asset classes. It is likely that one asset class becomes dominant (overweight) relative to the others decreasing the diversification of the portfolio.

It is necessary to rebalance to achieve proper diversification.

Rebalancing is done by selling the asset which has outperformed and buying the asset which has underperformed. In a way it replicates the maxim of "buy low, sell high", booking profits at higher levels and re-entering at lower levels.

There are quite a lot of such opportunities to rebalance the portfolio to take advantage of the intra-year shifts in asset performance.

For example, the chart shows the outcome if investors had invested in a "triple asset" portfolio comprising equal amounts of equity, bonds and gold over the past 17 years, rebalancing monthly.

Simply investing equally in the three assets without rebalancing would have resulted in INR 100 invested in December 1994 growing to INR 552 by December 2011.

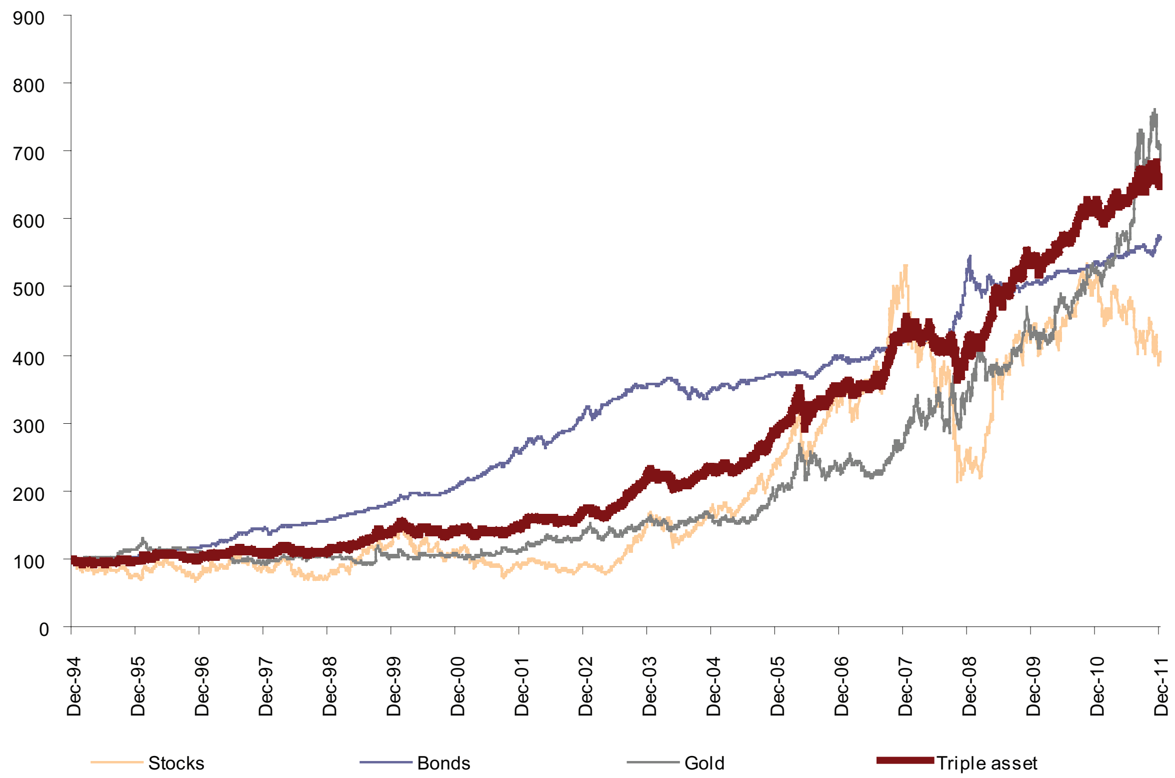
But if an investor would have rebalanced, the portfolio would have risen to INR 648, much closer to the best-performing gold (694).

AXIS TRIPLE ADVANTAGE FUND

Maintaining an asset-allocation strategy and rebalancing regularly involves much time, transaction costs and, possibly, the need to pay short-term capital gains taxes.

Axis Triple Advantage Fund mitigates much of this by having a disciplined investment process that has a well-defined asset allocation pattern which automatically rebalances the portfolio. As the rebalancing occurs within the fund, the transaction costs are lower. In addition, the fund does not pay any capital gains tax on such rebalancing. The fund rebalances its portfolio on a monthly basis.

Rebalancing, the asset allocation secret that no one talks about



relax. IT'S AXIS. AXIS MUTUAL FUND

5 reasons why the Axis Triple Advantage Fund is for you.

- Diversification across asset classes leading to reduction in risk.
- Returns potential not compromised even with reduced risk levels.
- Returns more stable than pure equity or gold investments over the long term.
- One single application for investment in three asset classes.
- 20% - 30% of your investment in gold, as gold is a good hedge against financial crises.

Statutory Details: Axis Mutual Fund has been established as a Trust under the Indian Trusts Act, 1882, sponsored by Axis Bank Ltd. (liability restricted to Rs. 1 Lakh). **Trustee:** Axis Mutual Fund Trustee Ltd. **Investment Manager:** Axis Asset Management Co. Ltd. (the AMC). **Risk Factors:** The sponsor is not liable or responsible for any loss or shortfall resulting from the operation of the scheme. **Mutual Fund Investments are subject to market risks, read all scheme related documents carefully.**

Co-published with Religare Macquarie

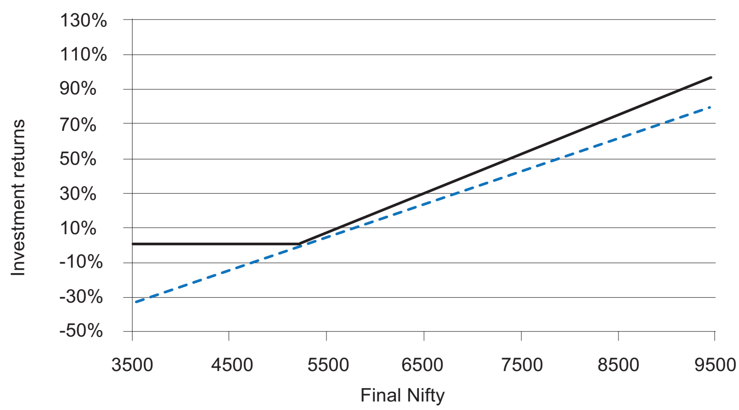
STRUCTURED PRODUCTS FOR PROTECTION AND YIELD

Times are changing. Financial markets are evolving and so are the needs of the investors as they gain a better understanding of the risks and returns and they become more aware of financial products.

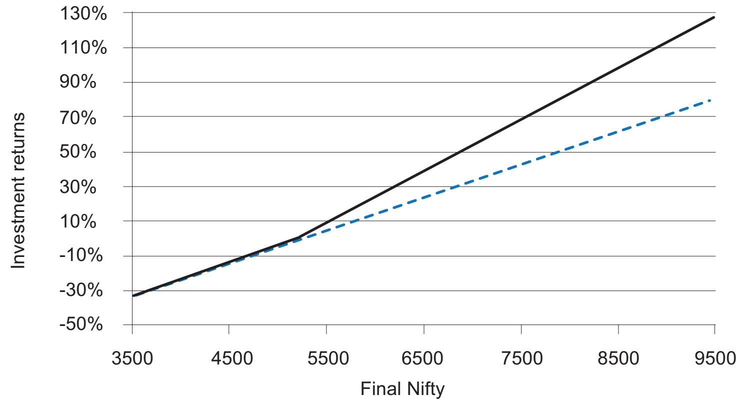
In this economic climate, where volatility and instability has become a norm rather than an exception, high net worth investors are willing to consider products that offer alternatives to traditional investments as they seek investments that have the potential to offer interesting ways to generate attractive yields.

Structured products are one such investment option. These are hybrid investments that combine the characteristics of two or more asset classes to provide unique benefits to the investor. They are designed with traditional fixed income features, such as a set maturity date, and can have principal protection, yet their return is generally

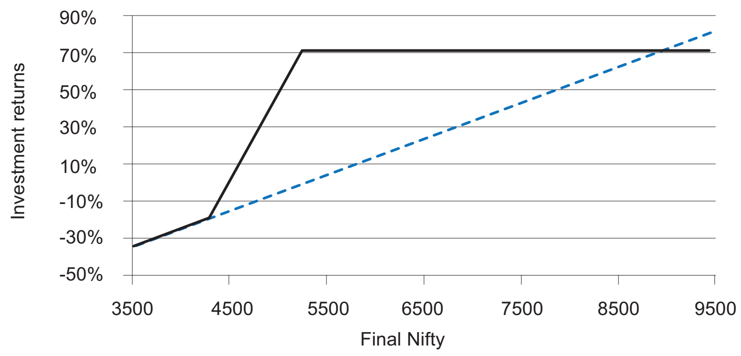
Example of principal protected structured product



Example of a non principal protected structure



Example of a flat market structured product



derived from the performance of an underlying asset class such as equity or fixed income indices, equity baskets or individual equities, commodities or currencies. These products are designed to facilitate highly-customised risk-return objectives.

Structured products have evolved over time, and are typically customised in line with a particular market view.

In India, most of the structured products are based on the Nifty as the underlying reference index. Stock-based structures are also popular with some of the aggressive investors (these investors are typically relatively sophisticated who understand the underlying risk-return dynamics).

The Indian wealth management industry has utilised this instrument and its features to help sophisticated investors meet the following 3 objectives in their portfolios:

1. Protect capital and still participate in equity growth using principal protected (PP) structures

These structures allocate a substantial portion of the invested amount into debt instruments, in turn bringing stability and protection at maturity. The remaining portion buys exposure in the underlying using derivatives.

To put things in perspective in the current scenario this product may have the potential to provide 1.2 times the upside of equity movement across time frames chosen. Conversely however, if the market performance is negative, this product would protect investor capital.

2. Get enhanced participation with downside risk using non-principal protected structures

These products are relatively aggressive and can provide partial or no protection (they can fall as much as the underlying index).

These generally fit the core long-only bullish portion in the sophisticated investor portfolio. The merit of taking a possible downside is reasonably compensated with enhanced return potential on the upside.

To put things in perspective, in the current scenario this product would have the potential to provide 1.6 to 1.8 times the upside of Nifty movement across the chosen time frames. Conversely, however, if the market performance is negative, the loss will be in line with the index performance. By giving away downside protection, the product can generate significant alpha over the underlying (Nifty).

3. Hedging equity exposure in portfolios

These are unconventional structures developed to hedge (investment position intended to offset potential losses) investor portfolios for the two most prominent risks – downside protection on equity exposures and the risk of a flat market over long periods of time.

For example, to help mitigate the risk of flat markets, a three-year structure can be designed to have the potential to generate a cumulative 71% return even if the final level after three years is same or above the initial index level and provide partial protection, subject to the terms of the product.

The graph on the previous page indicates that the product is ideal to mitigate the risk of flat markets since it gives a fixed coupon even if the market remains flat for three years.

There are several other combinations which can be designed to hedge the equity exposure of a high net worth individual's portfolio.

ADVANTAGES AND DRAWBACKS OF STRUCTURED PRODUCTS

Key advantages of structured products include:

- Investment protection
- Elevated market participation
- Reduced volatility within an investment
- Can be used to hedge overall portfolio
- No fund manager risk
- Defined return pay-off scenario
- Can be customised per specific client needs

Some key drawbacks of structured products include:

- Investment is locked in
- Early exit not guaranteed – premature withdrawal is on a best-efforts basis
- Credit risk of the issuer
- Complex products

HOW MUCH SHOULD AN INVESTOR ALLOCATE?

Since these instruments help investors achieve diverse risk-return objectives in various market conditions using different underlying assets like equity, debt and commodities, they can form a part of any portion of an investor's portfolio.

In summary, structured products have a relatively high degree of complexity, but are arguably one of the most efficient financial tools that can be used to benefit a sophisticated investor's portfolio. The complexity and variety of these instruments make the role of a wealth adviser far more critical to ensure better understanding and optimal allocation in portfolios vis-a-vis other static or "traditional" investments. Wider interest and acceptance of these types of instruments has also led to a paradigm shift in SEBI's involvement in regulating these products to protect investor interest.

Religare Macquarie Private Wealth (RMPW) has successfully ideated and recommended various structured products to its sophisticated clients over the years. While we believe in innovation and creating investment solutions that provide genuine diversification to investors' portfolios, we advocate that advice should be sought and risks understood before making any investment decisions.

Our strong recommendation is to focus on a portfolio based approach of asset allocation rather than a product-based approach.

** The examples in this article are for illustration purposes only and the actual returns may depend on features of each product.* ■

> "Structured products have a relatively high degree of complexity, but are arguably one of the most efficient financial tools that can be used to benefit a sophisticated investor's portfolio."

Co-published with World Gold Council

FUNDAMENTALS OF THE GOLD MARKET

Gold has been one of the most talked about asset classes in the last decade and its significance has become even more pronounced due to the multiplicity of economic issues that have arisen around the world since the recent economic crisis.

There are some key factors that determine the gold market at large, and their significance to the wealth management customer and adviser.

DEMAND FACTORS

There has been a significant change in the demand patterns of gold in the last decade. These have been the result of the gradual shifting in the economic centre of gravity around the world. It has also been due to a change in buyer attitudes, due to the significance of gold as an asset class in difficult economic times.

Some of the key changes have been:

1. Asia today accounts for more than 60% of the world's gold demand.

> India and China alone account for about 50% of global consumer demand.

Of this, India and China alone account for about 50% of global consumer demand.

This has been driven mainly due to the rapid rise of these economies and the resultant swift increase in their per capita income and total household savings in the last decade. Given the further expected rise in these economies and their socio-cultural affinity to gold, they will continue to dominate the global gold demand and given the close difference in total gold tonnage between India and China, their gold demand is being closely watched

2. There has been a significant increase in the investment demand for gold among investors in the last decade, ie. physical gold bought in the form of bars and coins, ETFs and other physical gold-backed financial products

3. Gold-backed ETFs have been a rapidly rising asset class within the asset management industry globally and in India.

   The World Gold Council Gold Demand Trends (GDT) report for the third quarter (Q3) of 2012 shows demand for ETFs and similar products in Q3 was up by 56% on the previous year

4. One of the most dramatic shifts in the demand pattern has been with the central banks globally. Central banks which were net sellers until a few years back have turned net buyers, led by the emerging market central banks. This has hugely contributed to the global demand moving up in the last few years. For example, to illustrate the increase in central bank buying, the Q3 GDT shows that in six out of the last seven quarters, central bank demand has been around 100t which is a sharp increase from as recently as 2010

5. Technology has been a significant contributor to gold demand. Gold's unique qualities as a superior conductor of electricity, combined with its malleability, ductility and non-corrosiveness makes its play a very important and irreplaceable role in some very high technology areas like electronics and aircraft engineering. However, following the steep increase in the gold price, manufacturers have looked to other materials to substitute gold-bonding wire which poses a challenge for the use of gold in electronics

> Investors sometimes tend to include gold along with other commodities in any kind of portfolio and/or investment analysis.

SUPPLY FACTORS

The supply side has also seen shifts in the last decade, and this has also affected the way in which the gold market behaves:

1. **Geographical spread:** Until a few decades ago, more than half the world's gold came from South Africa. Today the supply has become much more diverse and spread across much more "stable" geographies. The key gold-producing countries now are China, Australia, the US, Russia and South Africa. This makes the supply of gold a much more stable dimension vis-a-vis some of the other commodities like oil, which tend to be centred around rather volatile regions

2. **Diminishing mining supply:** The mining supply of the metal has been at the same level for the past decade. This is in spite of the fact that the price of gold has gone up many times which should have logically encouraged further mining. This is because new finds of underground gold are getting more and more difficult to discover, thereby restricting the scope of increased production, and encouraging gold recycling

3. **Increased cost of supply:** There has been a sharp increase in the cost of mined gold in recent years. This is primarily because miners are now mining lower-

Global demand for gold is likely to stay robust in the long term as it is now being driven by the growth in emerging economies, primarily India and China, which have a huge socio-cultural affinity to gold.

quality grades of ore due to the limited supply

4. **Recycled gold:** Currently it is estimated that the total stock of gold ever mined and held over-ground approximates about 171,300 tonnes. Compared with this, the amount of gold available to be mined is only about 51,000 tonnes. This has meant that the amount of recycled gold has gained more and more prominence in the last few years as a component of the gold supply

GOLD AS AN ASSET CLASS IN A PORTFOLIO

Investors sometimes tend to in-clude gold along with other commodities in any kind of portfolio and/or investment analysis.

But there are several unique factors that make gold a truly unique asset class and therefore should not be included along with other commodities:

1. **Low correlation:** Gold has a very low correlation with most key asset classes particularly in a normal market

2. **Hedge against tail risk:** Gold at the same time tends to have a very negative correlation with other asset classes during tail-risk market events

3. **Hedge against inflation and currency depreciation:** Gold has been seen to be a very effective hedge against inflation and adverse currency movement, particularly the US dollar. In the Indian context, as the price of gold is internationally determined in US dollars, it provides a very effective hedge against the depreciation of the Indian rupee

4. **Low volatility:** Gold tends to show much lower volatility as opposed to many of the other risk asset classes, for example equities and currencies

5. **Liquidity:** Gold is one of the most liquid assets in the world. While most of the global gold trading happens in the over-the-counter market, it is estimated that over US$240 billion of gold is traded every day – making it the most liquid asset after the US Treasury

These characteristics make gold an essential risk diversifier in any portfolio.

CONCLUSIONS FOR THE WEALTH MANAGEMENT ADVISER / CLIENT

- **Global demand for gold is like-**ly to stay robust in the long term as it is now being driven by the growth in emerging economies, primarily India and China, which have a huge socio-cultural affinity to gold. This is also getting further enhanced by the emerging market central banks looking to rebalance their reserves.

- Global supply will stay constrained as miners struggle to find new or viable mines and cope with the hugely-increased mining costs.

- Gold, with its unique investment characteristics, will continue to play a key part in the investor portfolios globally, particularly in this volatile and uncertain economic environment. ■

Co-published with Forefront Capital

CREATING THE WAY FOR HEDGE FUNDS?

Hedge funds are an important part of the global alternative investment world, but have remained largely absent from the Indian market because of regulations. SEBI's new Alternative Investment Regulations effectively give birth to hedge fund structures through Category III funds, says Radhika Gupta, Forefront Capital founder and head of business development.

With the kind of reputation hedge funds have acquired post-2008, market participants have reacted with a mix of enthusiasm and scepticism to SEBI's new Alternative Investment Regulations, issued in July 2012.

However in the long term, there is lot for investors to be excited about.

WHAT DO HEDGE FUNDS MEAN FOR INVESTORS?

While the term attracts a lot of public attention, the reality is that with regulations mandating a INR 1 crore (US$100,000) minimum investment, hedge funds cater to a very small group of individuals. Individuals will allocate between 1% to 5% of their wealth to hedge funds, limiting this category to individuals with at least INR 20 crores in liquid assets.

For these individuals, however, hedge funds offer a new risk-return profile. If offerings are in line with their global counterparts, Indian investors will see absolute return funds that are uncorrelated to the markets, taking risk between fixed income and equities.

Traditionally, alternative investments for this group have meant private equity and real estate funds, and with hedge funds investors will gain exposure to new asset classes such as currency, art and equity derivatives.

In addition, investors will get new kinds of "exposure" – short-biased, long-short or market neutral, and leveraged exposure.

WHAT KIND OF HEDGE FUNDS WILL APPEAR?

Global agencies have many hedge fund classifications, but Indian markets are likely to see a much smaller sub-set of funds, because of the restrictions around asset classes, particularly investing in global assets.

The most prolific strategy is likely to be **long-short equities**, where managers take both long and short positions in stocks, as opposed to conventional long-only investing. Mutual funds and PMS players cannot offer these strategies, and with markets being range-bound over the last few years, there is a growing interest in long-short. Long-short itself will have a number of variants – long-biased, market neutral and short-biased.

Another interesting space is likely to be **event-driven** strategies, where managers exploit specific opportunities around mergers, corporate actions, FPOs, and buy-backs, something that is done in an unorganised way already.

Derivatives-based strategies around currency derivatives, managed futures trading and high-frequency trading are likely to be popular with the increased proliferation of futures products.

Multi-asset funds which combine a range of asset classes will also provide a more diversified investment option for investors. What will emerge is heavily-dependent on the development of investment products by exchanges, regulatory controls on asset classes, and clarification on the tax regime for products.

Radhika Gupta
Forefront Capital

"There is likely to be a wave of players launching hedge funds in India"

> Global agencies have many hedge fund classifications, but Indian markets are likely to see a much smaller sub-set of funds, because of the restrictions around asset classes, particularly investing in global assets.

WHO IS LIKELY TO LAUNCH HEDGE FUNDS?

As there was with private eq-uity 10 years ago, there is likely to be a wave of players launching hedge funds in India.

Existing PMS managers already dabbling in alternatives are likely to launch hedge fund products, as are foreign and domestic asset management companies with strong global investment management foundations.

Proprietary trading desks which have been experimenting with derivatives and leverage with their own capital are also likely to come out of the woodwork and venture into regulated asset management.

Global hedge fund players like DE Shaw, which is present in the Indian markets in different ways, may also enter the market.

However, limited liquidity and the lack of scale in the markets may not justify a presence just yet.

Again, like private equity, an increasing number of global hedge fund managers are returning to India as the country's capital markets develop, and may play an important role in building the hedge fund industry.

WHAT TO WATCH OUT FOR WITH HEDGE FUNDS?

Any new industry goes through its share of ups and downs; the hedge fund industry is likely to have a bumpy road for the next couple of years.

Any good global hedge fund manager will say that hedge fund investing is as much (if not more) about managing risks as it is about managing returns.

There are two categories of risks that an investor or private banker needs to be wary of – investment risks and operational risks.

- **Investment risks** in hedge funds are unique because it is one asset class where investors can lose more than the capital they have invested. Leverage when used in the right measure can be used to enhance returns, but leverage used without caution has proved disastrous.

  SEBI has already talked about limiting leverage in funds, but a great degree of self-monitoring is also required.

  Promises of astronomical returns using leverage should be eyed with great caution, because very few investors can stomach the downsides of leverage.

  Derivatives, which will be a critical component of hedge funds, are also far more complex instruments than vanilla debt or stocks. Very few managers have experience trading derivatives at a large scale, and this is tricky in a market where derivative liquidity (particularly in single stocks) can often be spotty.

- **Operational risks** are risks associated with the firm and the broader investment infrastructure around it, and it is a space global investors are paying more and more attention to.

  These could be things like improper accounting methods or valuations, which should be very clearly laid out, or inexperience among traders.

  Managers which rely only backtest risk data mining and the risks associated with limited stress testing. Finally, cornering of markets or improper market practices is something regulators will monitor with a hawk's eye, and is something investors should look out for.

  Investors should be careful to evaluate a manager's asset management experience, ask them questions about worse-case scenarios, and make sure managers are backed by strong custodians, fund accountants and auditors.

IS INDIA READY FOR HEDGE FUNDS?

The short answer is yes, but in measured steps. The four components of the investment ecosystem – managers, private bankers, investors and counterparties – need time to make sense of this new asset class.

While everyone would like to see hedge funds immediately launch and raise billions of dollars in the domestic market, asset classes that grow too quickly and up bruising investors.

What the ecosystem needs is for a few good managers to launch well-thought out and calibrated strategies, raise money from select clients which understand what they are doing, and most importantly, perform.

A good experience – in terms of returns, risks experienced, and hygiene factors – in the first few funds will take the industry a long way.

Managers should focus on delivering performance without taking large risks, without worrying about raising large funds because a hedge fund just needs INR 20 crores to get started.

Private banks should focus on educating their relationship managers and bankers, as well as clients, on the real risks and rewards of this asset class.

Investors have to evaluate what funds to participate in, and ideally allocate a small percentage of their assets to this opportunity.

Finally, India needs a strong investment infrastructure in form of solid custodians with good derivative-accounting policies, auditors who know what questions to ask, and a tax code that clearly lays out the implications of hedge fund investing. ■

Co-published with Phoenix Marketcity

REAL ESTATE INVESTING

Amit Sathe, head of marketing and sales at Phoenix Marketcity, discusses real estate deals and deal structures.

Investors constantly ask financial advisers about why they should consider investing in equities when they can invest in real estate.

Private banking investment consultants give a numeric answer which sounds something like this:

1. Long-term real estate returns are 14% CAGR (valid for Mumbai). If you add a rental yield of 2% to 3%, then the total returns are 16% to 17% CAGR.

2. The Sensex has returned 18% from base 100 in 1978. If you add

"Most people are forced to be long-term investors in real estate due to low liquidity and high transaction costs, while it takes a huge amount of self-discipline to be a long-term investor in equities."

a dividend yield of 1.5%, then you get 19.5% CAGR.

3. The 2% to 2.5% difference in CAGR can become a big difference over your productive lifespan of 30 to 35 years from the time you start working until retirement.

But talk to anyone in India and you will realise that, like investments in gold, investments in real estate are more about passion than logic.

However, as a real estate professional, let me attempt to give a logical answer to support real estate investments.

Most people are forced to be long-term investors in real estate due to low liquidity and high transaction costs, while it takes a huge amount of self-discipline to be a long-term investor in equities. Since most people lack the discipline, it is easy to find people who made good returns in real estate but rare to find people who built their wealth in stocks.

Real estate has some other advantages, too. You can use leverage by getting a long-term housing loan at very cheap rates, but for shares you have to pay very high interest if you wish to leverage your bets. As long as you are paying your EMIs, the bank does not force you to sell your house even if the housing prices collapse temporarily. On the other hand, if your margin calls get triggered when the stock market collapses, the lenders will liquidate your stock holding forcibly at the worst possible time.

Having made a convincing argument about why real estate investing works, let's now look at what are the types of investments that one can make.

> “You can use leverage by getting a long-term housing loan at very cheap rates, but for shares you have to pay very high interest if you wish to leverage your bets.”

BY PROPERTY TYPE

Generally, real estate investments can be classified by type of property and by type of investment:

1. Residential
2. Commercial
3. Retail
4. Industrial
5. Land
6. Infrastructure
7. Warehousing
8. Movable property (fixtures)

While the first six are fairly well-known categories, so don't need much explanation, let me make an attempt in introducing the last two categories.

Warehousing

Driven by growth in production and consumption, organised retail, logistics outsourcing, modern assets and the likely rollout of Goods and Service Tax (GST), the demand for warehousing space is estimated to grow from around 391 million square foot in 2010 to 476 million square foot in 2013, growing at 6.8% CAGR during this period according to a KPMG report, which is entitled "Warehousing Opportunities in India."

Among the key sectors, the highest growth is expected from engineering goods and IT, and electronics and telecoms, since their warehousing demands are estimated to respectively grow at CAGR 8.6% and 8.2% between 2010 and 13. The other sectors are estimated to witness growth rates in the range of 5.7% to 7.1% CAGR.

Movable properties (fixtures)

A recent trend in leasing of commercial spaces in India has been leasing of fit-outs and fixtures within the office space. Some reasons why this trend is catching up quickly with corporate across India include:

- To free-up cash / reduce capital expenditure on non-performing assets
- To realise significant cash deductions

Some companies like Rentworks have made a head-start into this type of investment but private investors are fast

The already exciting real estate market in India has been spiced up with the current demand / supply situation on cash-flows.

catching up. Arguments against these investments are typically related to: why invest in a depreciating asset? The counter argument to that is:

- An average of 15% to 18% interest of total capital investment as part of rental pay-outs is readily available on these types of investments
- Even after the asset is 100% depreciated in the books (typically over five years), the value of the asset is at least 15% to 20% in scrap value
- More importantly, the corporate don't move every three to five years and hence one enjoys rentals on the said asset for much longer then the stipulated depreciation period, thus making the total return on the investment close to 140%
- As an investor, therefore, there are at least two new avenues that one can look at with the type of real estate to buy.

BY INVESTMENT TYPE

The traditional view of looking at investment types would be equity, debt and strata purchase. The typical options for these are:

- **Equity:** real estate stocks, real estate equity funds
- **Debt:** lease discounting, mezzanine loans, etc
- **Strata purchase:** physical purchase of units in any development

But the recent economic downturn has opened up various innovative deal structures in the Indian real estate market for individual investors. While some have been prevalent in the industry for a long time, some have been recent inventions born out of the financial crunch faced by developers.

1. **Hundi loans**

   unsecured short-term loans given to developers by traditional investors. These are loans given without security based on pure trust and mostly backed by nothing more than the promoter's guarantee. Average interest earned ranges from 18% to 36%, along with leverage on the developer in his future developments.

2. **Sell & buy-back structures**

   Investors invest money at a project level against the security of a registered transaction for a suitable carpet area in that development. However, the developer gives a guarantee, either written or verbal, to buy back the space at a much higher price.

3. **Debt convertible to pre-leased strata-buy structure**

   In commercial developments where the development is complete and is awaiting a tenant, an investor buys the available space. This purchase is considered as a loan with an annual interest ranging from 14% to 18% until the property is leased. Once the property gets leased the price is fixed at a 9% to 10% ROI calculated on the basis of the rental income generated from the property.

4. **Floating area / option agreement structure**

   An investor invests money at the project level at a pre-defined (usually lower than market value) price with an option agreement signed between the developer and investor. The area assigned remains floating (not assigned to specific units) within the development. The developer then further, at the insistence of the investor, sells the area assigned further to other end-users / investors and the capital gains generated between the pre-defined price with investor and final sale price with end-user are either shared or handed over to the investor.

Overall, the already exciting real estate market in India has been spiced up with the current demand / supply situation on cash-flows. ■

Co-published with Religare Macquarie

REAL WORLD PORTFOLIO CONSTRUCTION

In this article, we summarise our research on one of the most discussed, but least-concluded debates in the investment community: how should investors structure their portfolios to protect against the equity market volatility experienced in recent years? Many investors are choosing to answer this question by simply staying in cash, but as discussed below, that could in fact be the riskiest strategy of all.

SECTION 1: THE KING IS DEAD. LONG LIVE THE KING!

"A good portfolio is more than a *long list of good stocks and bonds. It is a balanced whole, providing the investor with protections and opportunities with respect to a wide range of contingencies." (Harry Markowitz, Founder of Modern Portfolio Theory)*

"The financial markets generally are unpredictable. So that one has to have different scenarios.... The idea that you can actually predict what's going to happen contradicts my way of looking at the market." (George Soros, Billionaire Investor and Philanthropist)

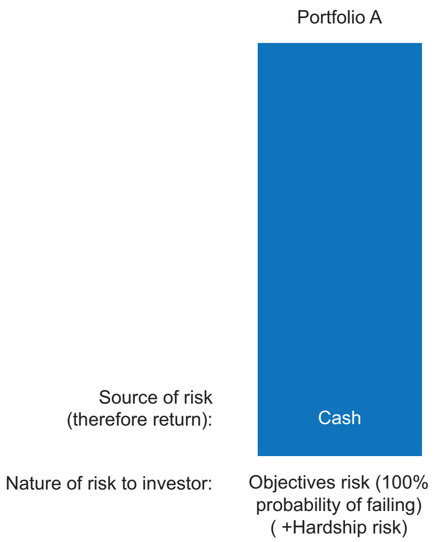
Markowitz was the founder of what has become known as "modern portfolio theory" (MPT). Markowitz's theory is elegant and simple, and won him the Nobel Prize for Economic Sciences. Markowitz, like Soros 50 years later, was compelling investors to consider a wide range of scenarios. Over the past few years, those investors that have heeded the advice of Markowitz and Soros have been able to outperform those that haven't.

We start in Section 2 with a simple illustration of why any and all investments have a degree of risk, and then why diversification needs to be more than through equities and bonds only to ensure the diversification / asset allocation principle objectives are met.

Then in Section 3, we provide evidence to support this point by examining the asset allocation practices of the top-performing institutional investors in three of the world's largest and most robust investing communities: the US, Canada and Australia.

Specifically, we are looking for links between their asset allocations and performance, and looking for consistency across the globe.

Figure 2.x



SECTION 2: WHY DIVERSIFY?

Start with an investing couple with a US$200,000 portfolio entirely comprising cash.

Like every investor, that couple currently has one major risk: "objective risk" – the risk of not achieving their objectives. If their objectives are to have enough to maintain their standard of living in retirement, the risk they face is that they don't save or earn enough in the meantime to fund that standard of living.

A sub-set of "objective risk" is "hardship risk". Depending on the type of investor, this could go by many names, but for real people, "hardship risk" is the risk of so materially missing your objectives that you not only miss out on your desired lifestyle, you in fact also have to significantly downgrade your lifestyle.

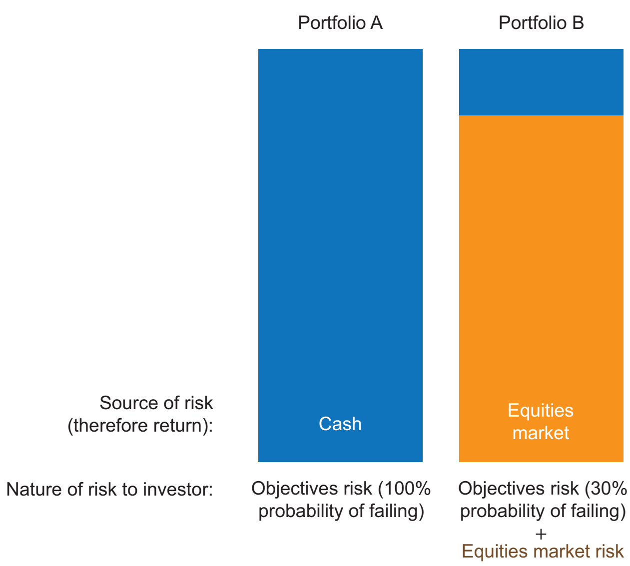
For our investors with US$200,000 invested in cash, the first question is: "can we earn enough from cash alone to fund our retirement?" Not even cash offers certain returns. For example, we can't predict what the five-year term deposit rate will be in five or 10 years' time, but the risk or volatility of returns is far lower than any other investment, and so we can answer this question with the highest degree of certainty that financial models can offer.

An investor lucky enough to have excess funds today to leave invested in cash will have the luxury of choice: leave the money and have 100% chance of achieving their goals; or take some risk and have a chance of exceeding those objectives, with some risk of failing to achieve them.

Other than the lucky minority of investors, the reality is that most investors do not have enough cash for today alone to achieve their objectives. That is, if they choose to remain 100% in cash, they are in fact 100% guaranteed not to achieve their objectives.

In the diagram, this is denoted alongside Portfolio A, 100% cash, with "100% probability of failure". In fact, the gap may be so large over time that staying in cash will guarantee that they underperform their needs by

Figure 2.y



such a large extent that they will need to significantly adjust their lifestyle, which we have denoted as "some hardship risk".

Therefore, to have any chance of meeting their objectives, they must take some risk.

Let's start with equities risk, the most readily available type of risk, and one of the most efficient in terms of persistently paying long-term investors for taking that risk.

Now we create Portfolio B, by investing 90% of his portfolio in equities. Their "expected return" exceeds more than required to achieve their objectives and so they have a 70% chance of matching or exceeding their target, ie they have dramatically reduced their "objective risk" from a 100% chance of failure to just 30%.

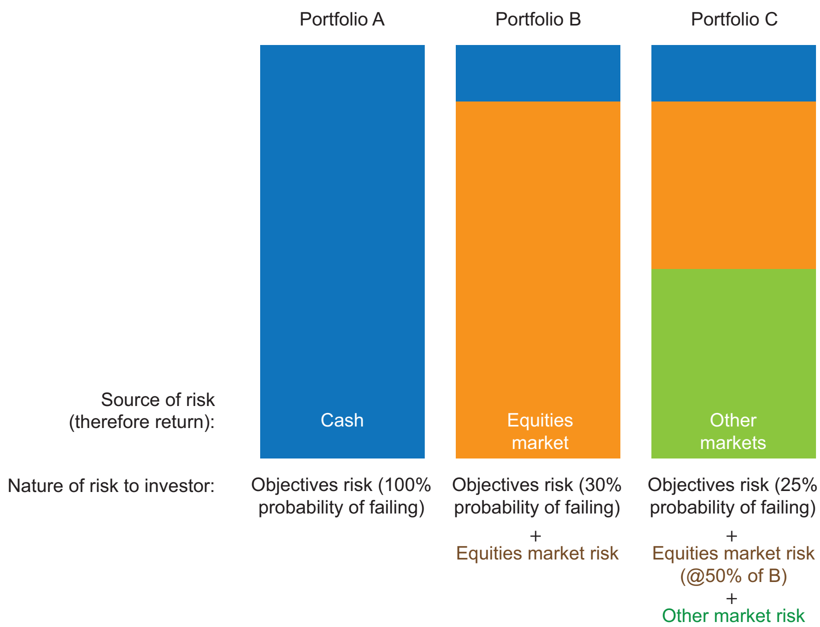
However, they have introduced a new risk – "equity market risk". And the two are linked – the reason that they still have a 30% chance of failing to meet their objectives is because there is a 30% chance that equities will not achieve sufficient returns to combine with the 10% in cash to meet their overall goals.

The problem is that "equities risk" is a volatile risk, as we have seen recently. And despite what the academics may assume, risk is not symmetrical for real people. The pain of falling short of your objectives is much greater than the reward of exceeding them by the same amount, increasingly so the further short you fall.

"Hardship risk" only exists on the downside. And while academics might refer to a "1 in 100-year scenario", like the global financial crisis, the impact of that scenario is so significant that portfolio construction must try to reduce its likelihood as far as possible.

If there is an equities sell-off just before our couple retires, they will suffer falls across 90% of their portfolio.

Figure 2.z



Whether invested in domestic equities, global equities, emerging market equities, private equity or long/short equities, the falls were severe for so many investors over the past five years.

So how can this large exposure to a single market event be addressed?

Portfolio C does this by introducing other types of market risk, example property market risk; bond market risk; commodity market risk. (Note that we still haven't introduced "manager skill risk" – this is another layer of risk altogether that needs to also be taken into account.

In Portfolio C, we retain 10% cash allocation, but split the risky assets, ie those producing returns higher than cash, in half: 45% into equities and 45% into other market risk.

Now our "objective risk" has fallen to 20% (ie we have an 80% probability of meeting our objectives) and we have half the "equities risk we had in Portfolio B, but we have introduced a new risk: "other markets Risk (in practice this would obviously be described as "property market risk"; "bond market risk", and so on, depending on specifically which markets were chosen, but for the purposes of this illustration, "other markets risk" is being used).

In addition to generally reducing "objective risk" and "equity market risk", we have reduced the more severe impact of a steep equities market downturn by 50% by shifting 50% of the equities allocation in other markets and in doing so, greatly reduced the chances of our portfolio underperforming so severely that our way of life is threatened.

That is, we have all but removed "hardship risk" (illustratively, if Portfolio B has a standard deviation of

Top performing global institutions' asset allocation vs typical retail investors

Jurisdiction	Equities	Fixed interest	Other eg property
Average for top performing global institutions	54%	21%	25%
Average for bottom performing global institutions	56%	33%	12%
Traditional balanced portfolio (typical of retail investors)	74%	12%	14%
Institutional approach applied to retail needs	54%	23%	23%

Source: Institutional investors: sources as per Appendix A. Retail investors: Based on xxx,000 retail superannuation accounts.

15% to 20% pa and Portfolio C is 12% to 15% pa due to the diversification benefits of the other asset classes, the probability of hitting a "hardship" level of say just 50% of target falls by 99.5% to 99.9%).

Similarly, by reducing our investors' exposure to a single market – equities – we are providing them with greater comfort. This is in terms of less stress associated with the highly-publicised daily movements in equity markets, which ultimately means they are more likely to stay the course.

SECTION 3: ADAPTING INSTITUTIONAL APPROACHES

Diversification works in theory but many investors have had a poor experience with the practice. They believed their portfolios to be diversified going into the 2008 crisis, but they were not. However, this does not mean diversification has failed. It means that the practice of relying entirely on equities (global equities, domestic equities, and emerging market equities) for growth and fixed interest for protection is flawed.

Meantime, many of the world's largest investors were truly diversified and experienced half the losses of the average investor.

We made this finding when we examined 994 of the largest institutional investors in Canada, the US and Australia, with US$1.1 trillion between them.

We found that those that spread their risks over a broader universe of asset classes than just equities and bonds, persistently outperformed before, during and after the worst of the global financial crisis. In fact, the top allocators to this asset allocation strategy outperformed by 6.5% pa in the US in the 12 years to 2010.

The persistent results from this analysis were a strong link between outperformance and:

1. More diversification
2. Less equities
3. Less bonds
4. More unlisted property
5. More "other" (hedge funds, etc)

> Many of the world's largest investors were truly diversified, and they experienced half the losses of the average investor.

SECTION 4: REAL WORLD PORTFOLIO CONSTRUCTION

"The way to become rich is to put all your eggs in one basket and then watch that basket."

For someone with as much extraordinary foresight and appetite for risk as Andrew Carnegie, one of the founders of the US steel industry, putting all your eggs in one basket is fine.

But for those of us without such an appetite or the ability to see the future with 100% certainty, all eggs in one basket – or more specifically, all our wealth exposed to equities volatility – is a poor strategy.

MPT provided the framework but some of the practices created since have created excessive exposure to equities in particular and a failure to truly diversify. The reality for many investors over the past few years has been that they have had 80% to 90% of their volatility explained by volatility of equities markets. That means a lot of recent volatility, a lot of downside risk, and a lot of investors abandoning their long-term plan as a result.

Markowitz's original theory asks us to construct a truly-diversified portfolio, not one with 80% to 90% of its volatility linked to a single class of risk.

This article outlines several strategies that combine to provide a portfolio consistent with this definition of true diversification. These strategies and the resultant portfolios are neither "new" nor unique. They are commonly followed by some institutional and retail investors across the world, but unfortunately not by the majority.

Addressing the weaknesses of the common execution approach for MPT at Religare Macquarie have developed a portfolio construction philosophy around certain principles and beliefs, and specifically articulated a set of actionable strategies.

MPT is as sound today as it was when it was written over 50 years ago. Yet the approach taken by much of the industry is in need of significant overhaul to reflect the principles of these leading institutional practitioners.

So the King is not dead. Long live the King. ■

Guidelines for Real Diversification

Lesson	Guideline
1. MPT tells us to diversify risks, not assets	Asset classes are a often a poor proxy for the drivers of risks. Use "risk classes", not "asset classes"
2. 100% allocation to cash will usually result in 100% probability of failure	Don't avoid risks if they are necessary – take well-priced risks, i.e. get paid for taking risk
3. Risk is not symmetrical for real people – downside risk can cause lifestyle hardship	Diversify 'normal' volatility as well as 'Hardship Risk', i.e. the risk of extreme market events that force a severe shift in lifestyle.
4. Correlation in bear markets matters far more than average markets	Asset classes with high correlation to equities in equity bear markets should be considered "Equity Market Risk" not diversifiers
5. "Alternatives" is a misnomer.	Private Equity & long/short equity hedge funds are Equity Market Risk, not diversifiers of that risk.
6. Real diversifiers add real value	Consider each of the so - called alternatives as separate asset classes. Some provide real diversification.
7. Active managers in mainstream asset classes and styles have struggled to persistently add value	Only use active management where it materially exceeds fees and costs.
8. Optimisers using fixed assumptions are unrealistic	Don't use fixed assumptions. Trial a range of assumptions and find a portfolio that performs best across that range.

Best Wealth Management House in India

2012 · 2011

We are delighted to inform you that IIFL Private Wealth has been voted the **'Best Wealth Management House in India'** for the second year running by the Asset, Triple A Investment Awards. This is a great honor for us.

The consecutive awards in 2011 and 2012 reflect IIFL's pre-eminent leadership in the Indian wealth management space. It is a resounding vote of confidence in the innovations we have brought to the industry.

This accolade belongs as much to you as to us; it is your goodwill and trust that has made this possible. The award strengthens our resolve to serve you with humility, always.

IIFL

PRIVATE WEALTH MANAGEMENT

BROKER: ICICI SECURITIES - PRIVATE WEALTH MANAGEMENT

ICICI Securities' private wealth management business has the best of two worlds – it's part of the ICICI Group so can leverage all the services and products of the group, and has the strength of the investment banking and wealth management capabilities of ICICI Securities, a well-respected name in corporate finance.

Ashish Kehair had been part of ICICI group for around 10 years when he then took on the challenge of establishing a wealth management business within the ICICI Securities business.

He decided to start with a frugal mindset on costs. However, he also had a clear target of adding value to its clients in achieving its objectives.

The business became profitable in its second year of operation and is witnessing a robust and steady growth.

With a presence in almost every line of business, Kehair says he believes that the firm has the widest product platform, ranging from manufacturing to distribution on offer to investors.

The product platform is diverse, not relying on any one product type.

Kehair explains that client preferences do vary across geographies and having a diverse platform helps in serving the specific preferences of each region.

"At a specific geography level, the business might look skewed but when the national picture is taken into consideration, everything has equal share," he says. "Hence we are not over-dependent on any specific product." ■

Ashish Kehair
ICICI Securities

RMPW Wealth Advisor Profile

RELIGARE MACQUARIE
PRIVATE WEALTH

About Religare Macquarie

Religare Macquarie is the coming together of two dynamic financial powerhouses, Religare and Macquarie.

At Religare Macquarie Private Wealth, we provide our clients with the most innovative and customised wealth management solutions. Our inexhaustible range of products and services embrace all asset classes including Private Equity Funds, Real Estate Funds, Structured Products, Offshore Investments, Equities, Mutual Funds, PMS, Capital Markets Lending, Global Investment Services, Investment Banking, M&A and Legal and Tax Advisory Services, to name just a few.

We are committed to providing our clients and investors with best-in-class products and superior advisory services. Our key attribute and differentiator has always been our proactive, advisory approach.

Higher standards

Producing consistently superior results is a function of Religare Macquarie's commitment to higher standards in every area. From our back office to our core functions, Religare Macquarie Private Wealth favours creative problem solving and rewards independent thinking in people who focus on possibility rather than precedent.

Deeper resources

Religare Macquarie has brought together a team of outstanding researchers, analysts and technical experts who share vital information and insights. They deliver quality information that is used to guide our investment decisions and provide our clients with more informed strategic wealth and investment advice.

Priya Singh

Senior Vice President - Private Clients

Qualification: MBA - Finance, BBA and AMFI Certified, NCFM - Derivatives, Capital Market, Depository Modules, CFP and PhD
Work Experience: 10 years

Is this you?

"I take this business and your trust seriously. I work hard on your behalf, and do everything I can to ensure your financial future is an enjoyable one."

If you think you have it in you to be a part of our successful family, then you are the perfect candidate to be an outstanding Religare Macquarie Wealth Advisor. Please do write to us at active@religaremacquarie.com

scarecrow/rm/12/10/01

KNOWLEDGE ❯ IN ACTION

PRIVATE WEALTH: RELIGARE MACQUARIE PRIVATE WEALTH

Religare Macquarie is one of few stand-alone private wealth management firms in the Indian market that aims to bring together global expertise and local insights through a joint venture – between Indian-based Religare Enterprises and Australia-based Macquarie Group.

The business focus of Religare Macquarie Private Wealth (RMPW) is offering a comprehensive advisory proposition based largely on Macquarie's risk management and investment methodology – which "ensures the wealth management solution offered to clients is always in line with clients' investment objectives and risk appetite".

Chief executive officer Rohit Bhuta, a Macquarie veteran in setting up businesses in different geographies, says this vision is highly-achievable despite – and perhaps because – RMPW is a young organisation "operating in a highly-evolving and dynamic, yet nascent industry".

Bhuta is of the view that despite the mind-boggling statistics of the demographics and the market opportunities, very few, if any, established wealth management businesses are profitable.

"In fact, the promise of growth and market size attracted many new players' pre-crisis leading to a significant increase in the cost base which is now proving to be unsustainable," he explains.

There have been a number of business closures or significant downsizing within the industry in the past 12 months, including many well-known names. "This has created a catalyst towards industry consolidation," says Bhuta, adding that wealth management providers can now be categorised as banks, IFAs and stand-alone wealth management businesses like RMPW.

While most banks offer a wealth management proposition in one form or another, and while the number of IFAs is increasing, there are only a handful of stand-alone wealth management businesses solely focused on providing a complete proposition.

"This has provided businesses such as RMPW a significant opportunity to gain market share as a result of their sole strategic focus on private wealth management," says Bhuta.

RMPW prides in its overall proposition offering research-backed, third-party, best-of-breed advisory solutions to clients through its concierge services in:

- **Investments:** Religare Macquarie's comprehensive product suite covers various asset classes, like mutual funds, debt instruments, direct equity and commodity, insurance, PMS, and offers client's investment solutions across all risk spectrums and individual investment objectives

- **Real estate:** a real estate advisory proposition through RMPW Property Perspectives gives clients access to multiple, varied real estate investment options including primary and secondary offerings in residential, commercial and commercial pre-leased properties

- **Philanthropic advisory:** a strategic alliance offers philanthropic advisory services

- **Lending:** this is a comprehensive best-of-breed lending solutions

- **Wills and estates:** this provides advisory services on asset preservation, selection of executors and trustees, and the timely transfer to desired beneficiaries

Bhuta also leverages Macquarie's expertise in real assets by offering co-investment opportunities to ultra high net worth investors (UHNIs) in what he refers to as next-generational assets such as agricultural, environmental assets and resources.

RMPW also offers direct private equity investment opportunities for its UHNI clients, plus uses Macquarie's resources to offer structured products and advice on overseas investments through the liberalised scheme.

The Religare group expertise has also been brought in through trading platforms for equities, commodities and derivatives, as well as lending through Religare Finvest.

The proposition is completed, according to Bhuta, through RMPW's ability to offer private banking / investment banking opportunities through Religare Capital Markets and Macquarie Capital Markets, both of which have a strong presence in India.

The product platform is open architecture, offering best-of-breed products across all asset classes. The firm focuses on asset allocation.

Says Bhuta: "Our unique PGA (protection, growth and aspiration) model approach helps us classify clients according to their risk profiles before initiating asset allocation."

The industry continues to be faced with many challenges at multiple levels, adds Bhuta. "Certain challenges like the dearth of talent remains an issue, which in turn gives rise to newer challenges," explains Bhuta, adding. "The regulatory evolution, while a welcome and a fundamental requirement for the establishment of a robust and a mature industry, has given rise to newer challenges purely as a result of the speed of implementation."

Rohit Bhuta

Religare Macquarie Private Wealth

Certain developments like the move away from a commission-like upfront remuneration structure for distributors to an annuitised model is a step in the right direction; and one that will help add further trust and credibility to the industry overall, says Bhuta.

The industry is undergoing a rapid shift and evolution, says Bhuta, who thinks a long-term view is a necessity if one were to succeed and ultimately be significant in India: "Despite the challenges, the market represents a significant opportunity going forward for businesses that have the capacity and appetite to have a long-term view."

"I am very proud of my team and the proposition we have created at RMPW," says Bhuta, "and we are looking forward to setting benchmarks on our journey to significance." ■

PRIVATE WEALTH: KARVY PRIVATE WEALTH

Karvy Private Wealth targets a number of customer segments ranging from high net worth investors, affluent individuals, trading-oriented clients and non-resident Indians.

Karvy's business units include: Electus ("the chosen few" in Latin), aimed at high net worth investors (HNIs) with investable assets of INR 5 crores; a HNI business segment aimed at affluent investors; HNI Broking, aimed at high net worth traders; and the international business, aimed at non-resident Indians.

> Growth in terms of numbers is now happening through people who are migrating from the middle-class to the upper-middle class wealth tiers.

That is quite a broad mandate for chief executive officer (CEO) Sunil Mishra, who is an engineer by background and was regional head of marketing in the telecommunications industry before joining Karvy.

CEO and group head of Karvy, Hrishikesh Parandekar, has an even broader mandate incorporating asset management, broking and the realty business in addition to the wealth management arm.

His background in wealth management and strategy consulting comes in handy, with Parandekar able to bring to the firm his experiences as head of the Latin American private wealth and international retail businesses of Morgan Stanley, as well as his role with McKinsey Consulting, where he advised companies in the financial services sector.

When explaining the strategy of aiming at a broad range of clients, Parandekar says: "A major challenge for the wealth management industry is that different client and market segments have been lucrative at different points in time.

People are willing to go beyond bank fixed deposits and are looking for high-yielding forms of debts like corporate fixed deposit and more interesting real estate-backed debt.

Hrishikesh Parandekar

Karvy Private Wealth

He adds: "Hence, we have taken a broader approach to the market; we don't believe that wealth management is limited to the millionaire segment only."

While that segment continues to have the potential of larger ticket sizes, it has also become overbanked, so is now very challenging to make money from it.

"The conversation with the millionaire segment has become limited to a 'show-us-something-new' conversation," expains Parandekar.

He is much more bullish about the potential in the affluent segment. "Growth in terms of numbers is now happening through people who are migrating from the middle-class to upper-middle class wealth tiers," which he defines as INR 25 lakhs to INR 5 crores.

Karvy's talent strategy is pragmatic. "Talent acquisition is to be basically as opportunistic as we can," says Parandekar.

The firm hires people with existing books but also from related industries.

Once hired, Parandekar focuses on retaining them. "It's much easier to retain the medium-to-high performing individual rather than hire and train and bring someone on board," he says.

Admitting limitations of working on a non-banking platform, Parandekar says his firm focuses on advisory and product innovation.

While Karvy's product platform is open architecture and quite broad, Parandekar also manufactures product through an alternate asset management business. "Clients are looking at managed equity products and not just the conventional types," he explains. "There is also a lot of interest on doing equity on an advisory basis or non-discretionary basis, not only on a packaged product basis."

Karvy also looks beyond equities. "People are willing to go beyond bank fixed deposits and are looking for high-yielding forms of debts like corporate fixed deposit and more interesting real estate-backed debt." ■

Firm profile

BROKER: IIFL PRIVATE WEALTH MANAGEMENT

IIFL Private Wealth (IIFLPW) is led by three young and passionate entrepreneurs: Karan Bhagat, managing director and chief executive officer; Yatin Shah, executive director (domestic); and Amit Shah, executive director (offshore).

IIFLPW is backed by the institutional and domain ex-pertise of India Infoline Group, both on the retail and the institutional side. India Infoline Group, founded in 1995 by Nirmal Jain, was originally a business research house and information provider and has now evolved into a full-service financial and investment platform for institutional and corporate, private wealth and retail clients.

The firm has exhibited one of the fastest growths in assets under advice in the industry – but Bhagat believes his service offering is simple: "Where the firm has had to display innovation is in product structuring."

Around 90% to 95% of the IIFLPW's assets under advice (IIFLPW's assets under advice, custody and distribution assets aggregate to INR 32,000 crores as of September 30, 2012) are in traditional asset classes such as equities and debt with the balance in gold and real estate.

Bhagat doesn't shy away from trying new things.

"For example, we started selling NABARD bonds back in 2008. At that time, no-one else preferred it but today it is seen as stable."

Explaining why the firm has focused on debt instruments, he explains: "Clients have an affinity to be on AAA side; at

> "Around 90% to 95% of the IIFLW's assets under advice are in traditional asset classes such as equities and debt with the balance in gold and real estate."

a push they go to AA+ and very few end up going to AA-. Even fewer clients take up exotic debt. Today most clients are happy with a return of 9% or so on a post-tax basis

Karan Bhagat
IIFL Private Wealth Management

in debt, which basically means we need to add 1% more to AAA, which normally gives a return of 8%. So as a firm that's been the focus on the product side and a lot of innovation has happened to the fixed income side."

Giving another example of product innovation on the fixed income side, Umang Papneja, president and head of products, points to IIFL's gold loan securitisation product.

It securitises a part of IIFL's gold loan portfolio through issue of pass-through certificates.

The transaction provides the investors an excellent short-term, high-yielding, fixed income investment avenue.

Bhagat emphasises the importance of deriving mileage out of "ideation" in the period between when a product is launched and when it is copied.

He is of the opinion that clients always value the original manufacturer of the product. This approach has helped IIFLPW is able to "access respective clients, have slightly higher retention rates, and widen the share of wallet of existing clients."

Explaining the firm's fee model, Bhagat says it offers choice depending on the level of engagement with the client.

The firm offers discretionary services as well as non-discretionary services.

Under the discretionary model, it classifies portfolios into product-focused and portfolio-focused, while the non-discretionary model has product-based commissions.

Bhagat pegs the split at 40% to 45% for the discretionary model, 30% for the non-discretionary model, and 30% to 35% for the product distribution model. ■

"The firm offers discretionary as well as non-discretionary services. Under the discretionary model, it classifies portfolios into product-focused and portfolio-focused, while the non-discretionary model has product-based commissions."

FINANCIAL PORTAL: ADITYA BIRLA MONEY

Voted Product of the Year 2012 in the Nielsen Consumer Survey of Product Innovation, Aditya Birla Money's "My Universe" is a financial portal allowing individuals a single window view into their financial world, including their relationships with banks, loan providers, brokerages and mutual funds, covering just about any financial instrument.

When asked what led to the creation of the Aditya Birla Money Universe, Sudhakar Ramasubramanian, managing director of Aditya Birla Money Ltd (ABML) and chief executive officer of Aditya Birla Money Mart Ltd (ABMML), says: "When we looked at the customer they all posed one basic common problem: how to simplify the ones money management process."

> The portal and the firm is completely business-to-consumer, which is achieved through digital channels, their own IFAs and the sales team.

Adds Ramasubramanian: "The target audience for the portal is people falling into the age group of 25 to 40 and those who are digitally and technically literate."

He further stresses that the portal and the firm is completely business-to-consumer, which is achieved through digital channels, their own IFAs and the sales team.

Ramasubramanian divides the objectives and the purpose of the portal into three parts. The portal is about aggregating one's money relationship into one place. Around the aggregation is the advice and the analytics part, and the portal also provides the transaction platform.

"The technology used is the Yardney and the front-end has been built by the Birla team," says Ramasubramanian.

The website also has a stringent security system in-built with the password being encrypted, as Ramasubramanian says, "many times over".

He says: "The storage of the passwords and the associated data are closely protected by providing multi-level security

The site gives a 360-degree view of one's financial status like no other site does.

steps and storage of data at different places, further protected by passwords, thus restricting access by us as well."

Detailing the service, Ramasubramanian says the portal covers income and expenditure, and credit card payments on the behalf of the customer. It also keeps a track of all the bills in the financial calendar, does budgets and sends SMS' to the customer it they overshoot the limit.

In short, it is a PFM site where investments can also be executed and used at a monthly subscription rate of INR 500 per month.

Ramasubramanian says confidently that his product is different from all other such similar portals in the market.

"We have already won a 'Product of the year award' and the site gives a 360-degree view of one's financial status like no other site does. The site, also unlike other sites, is like a broking or product manufacturer site which limits the customers' access to their own products and services. Our site gives an overview of not only one's income but also of one's liabilities, investments and expenditures."

In terms of providing advice through the portal, Ramasubramanian says: "We back it with a research team for mutual funds, for equities and for derivatives, and we provide such research on the portal."

When asked if the portal helps with investors being able to calculate performance adjusted for cashflows, he explains:

"We also calculate xIRRs and tell customers how much money they made, daily, monthly, quarterly, etc."

Sudhakar Ramasubramanian
Aditya Birla Money

Ramasubramanian describes the portal as an "intelligent distributor." At the same time, it's not just designed to sell financial products – it's "a place where the investors can come and buy... it will work on behalf of the clients". ■

It's a place where the investors can come and buy.... It will work on behalf of the clients.

NATIONAL DISTRIBUTOR: NJ GROUP

NJ Group is led by two of the most respected entrepreneurs in the Indian wealth management industry today.

Sensing the investment opportunities that would come with the opening up of the Indian economy, two college friends, Neeraj Choksi and Jignesh Desai, started NJ India Invest in 1994. They then expanded the firm's operations to an IFA network, NJ Fundz Network in 2003.

Today, the group is the largest wealth network with more than 15,000 IFAs routing their business through the firm.

> "The group is the largest wealth network with more than 15,000 IFAs routing their business through the firm."

Jignesh Desai
NJ India Invest

The duo is excited as ever: "The opportunity lies in the fact that young Indians comprise 50% of the population with a low penetration in capital markets sector," they say.

Rather than lamenting the environment, the two see the glass half full: "The focus should be on factors that are under our control. For example, people invest heavily in fixed deposit schemes due to high interest rates and safe returns, which is why bank deposits are higher than investment in mutual funds. On the other end, there is ample opportunity in the life and health insurance products, due to increasing medical costs. Investments in the real estate market are lucrative, too."

Their aim is to identify the investments that are well-suited to the client and to avoid those that are external to the firm's control.

Explaining the firm's value proposition to IFAs, they focus on training and infrastructure support.

Choksi is passionate about adviser training: "Starting from recruiting the interested candidates till showing them a structured career path, NJ Invest educates potential advisers, showing them benefits of their own business venture."

Neeraj Choksi

NJ India Invest

> NJ Invest equips the potential adviser with research, marketing, customer support, administration and transaction facilities under one roof.

NJ boasts a cutting-edge online platform. Explains Desai: "NJ Invest equips the advisers to use their MIS that is designed to record earning from customers, employee performance, etc. We also have a CRM tool for new and existing customers, and provide them with a toll-free helpline."

On the transaction side, the firm offers an offline facility through form-filling and an online facility through the stock exchange and online banking.

With respect to marketing and brand building, the firm has the concept of a "biz mall", where the adviser can order things like newsletters and visiting cards in collaboration with NJ Invest.

The company also delegates its advisers that record, evaluate and analyse the individual adviser's performance and suggest ways to enhance their performance.

Choksi sums it up: "NJ Invest equips the potential adviser with research, marketing, customer support, administration and transaction facilities under one roof."

NATIONAL DISTRIBUTOR: BAJAJ CAPITAL

Bajaj Capital's history is as long as India's mutual fund industry – it started in 1964, the same year in which Unit Trust of India, the country's first mutual fund, was incorporated.

Bajaj Capital founder KK Bajaj set up the firm as an investment centre to guide individuals on where, when and how to invest.

His son, Rajiv Bajaj is carrying on the legacy today as vice chairman and managing director. He works with brother Sanjiv Bajaj and chief executive officer Anil Chopra.

Bajaj Capital has an offer for multiple client segments – retail, institutional and high net worth individuals (HNIs).

"We focus on the three different segments with different service and advisory offerings," says Rajiv Bajaj. The 125 branches cater to retail investors. Even there, he is passionate about financial planning rather than just distribution – indeed, he is the founding chairman of the Financial Planning Standards Board, India.

Bajaj Capital's service offering covers the entire spectrum of financial planning, covering risk mitigation planning and goal-linked investment planning.

Talking about talent, Bajaj says: "We hire both experienced and freshers regularly as per requirement in various units. We hire through reference of internal team members and

"The combined AUM of its own staff and the IFA network is more than INR 5,600 crores. The business is profitable."

also upgrade our better advisers to premium channels like Branch to LaPremier to Institutional advisory."

Bajaj Capital not only has 800 advisers across its categories, but also an aggregation network of IFAs. The 360-degree business solution offer provides IFAs access to infra-

Rajiv Bajaj

Bajaj Capital

structure that they wouldn't be able to build themselves, such as a wide range of products, research, marketing and business support, training and development, technology support, and an online investment platform.

The combined AUM of its own staff and the IFA network is more than INR 5,600 crores. The business is profitable.

Bajaj is optimistic about the potential for the industry with what he describes as a "growing economy with first-generation entrepreneurs creating abundant wealth".

However, he is also cautious about what he calls "investor awareness and fragmentation of the market through too many varieties of products".

But he is always ready to take on a leadership role in the industry. As he did with the Financial Planning Standards Board, Bajaj is now cajoling the wealth industry to come together as an association. ■

> Rajiv Bajaj is passionate about financial planning rather than just distribution – indeed, he is the founding chairman of the Financial Planning Standards Board, India.

Co-published with TATA Mutual Fund

THE NEED FOR PENSION FUNDS

The primary objective of any pension is to provide members of the work force with some income during their old age.

A pension is conceived to be a long-term financial contract under which an employee's contributions today are exchanged for benefits that will be delivered to him or her many years later.

It therefore follows that the assets created out of his or her contributions and accumulations must, and without fail, convert the current savings into future earnings in the form of retirement benefit to him or her without any excuse of adversely changing economic environment comprising of business cycles and imperfect and violent capital market conditions.

The contractual relationship also presumes, in view of its long-term nature, a highest degree of fiduciary relationship between the beneficiary and the pension fund manager.

ESTIMATED SIZE OF PENSION MARKET

Experts estimate the size of the pension market to grow as follows:

Year	Size of the pension market (INR billion)
2005	1166
2010	1569
2015	2154
2020	2986
2025	4064

Thus, post reform the pension market is expected to grow to INR 4064 billion by the year 2025.

This means that, on average, funds of the size of INR 15,000 crores per annum are expected to be available for investment through pension contributions to begin with.

This would add to the present annual investment accretion of investible funds of LIC and GIC. This gives an idea of the size of additional funds that will be available for investment.

It also determines the room for new entrants in pension fund management.

This would also indicate incremental demand for quality-grade long-term investment instruments, which are already limited in availability.

The relevance of pension funds stem from some impending risks that simply cannot be wished away.

> "A good pension system should maximise investment returns by wise investments and should keep expenses of the pension provider to the bare minimum. It should provide multiple options to cater to the different needs."

Replacement rate risk
This is the risk that the individual's post-retirement income is insufficient to provide a standard of living enjoyed while in service.

Post-retirement incomes must bear some relation to final salaries, since living standards are linked to these.

Consider an individual aged 40 earning a salary of INR 5,000 a month.

Given that income rises at 5% per year, the final salary at age 60 would be INR 13,265 [5000 * (1.05)20]. The replacement income at age 60 would thus amount to about two-and-a-half times of that earned at age 40.

Two types of concerns can be discerned here: first, about funding a rising liability; and secondly, the unpredictability of the rate at which income and living standards would rise in future.

Inflation risk
This can reduce post-retirement living standards in real terms. Real incomes are protected while one is in active service through suitable wage indexing. Would such a provision be available after retirement?

Social security risk
The refers to the possibility that Social Security and other retirement benefits may prove to be lower than what the individual had anticipated and planned for. Individuals have, in anticipation of this contingency, turned to personal pensions in recent years to recoup shortfall in expected earnings.

Longevity risk
This is the possibility that the individual might live too long after retirement and thus outlives his resources.

Investment risk
This is the possibility of retirement funds being rendered inadequate or even wiped out because the underlying investments performed badly relative to expectations due to default by debtors and / or a fall in the market value of investments.

CONCLUSION

Retirement income is an extremely important component of every individual's lifecycle.

Pension funds are powerful engines of growth and go a long way in strengthening capital markets as they provide large amounts of long-term funds.

A good pension system should maximise investment returns by wise investments and should keep expenses of the pension provider to the bare minimum. It should provide multiple options to cater to the different needs of different age and income groups.

A lot of consumer education is required to explain to the people the benefit of small savings over long periods to provide for a secure old age. ■

Feature article

REGULATING THE WEALTH MANAGEMENT INDUSTRY

Currently, the regulations do not recognise the profession of a "wealth manager"; indeed, the regulations do not even recognise the concept of "wealth or investment advice". Instead, they focus on execution or transactions.

It is assumed in the Indian wealth management industry that advice is part of the executive service. Hence, anyone wishing to provide advice and execution services on financial products has to follow the relevant guidelines for the "distribution" of that product type. Individual advisers and firms have to enter into distribution arrangements for mutual funds, insurance products, pension products, etc all separately.

In September 2011, SEBI issued a concept paper for industry comment giving the layout of the framework for regulating "investment advisers".

In August 2012, SEBI foreshadowed the Investment Adviser Regulations in the release of its board minutes along with the draft but has yet to release the final regulations.

Before we outline the developments on this, it is useful to look at the regulations that govern the distribution of mutual funds and insurance products.

MUTUAL FUNDS DISTRIBUTION

While the first mutual fund dates back to 1964 offered by Unit Trust of India, a government-owned entity, private players only started offering mutual funds in 1993 when the Mutual Fund Regulations were introduced. The industry now functions under the SEBI (Mutual Fund) Regulations 1996.

In 1995, the asset management industry also set up AMFI, a non-profit trade body.

Among its current objectives is one "to develop a cadre of well-trained agent distributors and to implement a programme of training and certification for all intermediaries and other engaged in the industry".

It started doing so by launching a certification programme in 2002 under which anyone who deals with mutual funds, be it advisers or manufactures, had to pass an exam.

Such persons would then register with AMFI and get issued an AMFI Registration Number (ARN).

The certification process was transferred from AMFI to the National Institute of Securities Markets (NISM), part of SEBI, in 2010. However, SEBI still required the successful candidates to register with AMFI and get an ARN.

Indeed, the process for distributor registration was strengthened through the "Know Your Distributor" (KYD) process under which a central firm collates data about ARN holders and provides it to AMCs.

So effectively, SEBI has given the responsibility of overseeing distributers to the asset management industry.

While the mutual fund regulations have been tweaked to keep pace with product and process issues, the most relevant change to impact the distribution / wealth industry was the abolition of entry loads in 2009.

Karan Bhagat
IIFL Private Wealth Management

"A long-only fund charging this much and consistently beating the index would be a difficult task"

In summary, SEBI banned mutual funds imposing up to 3% entry loads, most of which was paid to distributors for providing advice/execution services. The idea behind this move was that the wealth industry should represent the clients' interests rather than those of the asset management firms – hence the client should pay them directly.

The industry was shocked by this move as the lead-time was only six weeks. However, in the following three years the industry has found ways to still get an up-front commission as well as higher trail commissions from product providers. Yet both the wealth and asset management industries have both been suffering.

Interestingly, there wasn't much commentary about the irony of the SEBI changes; on one hand, SEBI believed the wealth industry should be paid by, and therefore represent, the investors, but on the other hand, it should be better regulated by the providers through the enhanced KYD process.

"Anyone wishing to provide advice and execution services on financial products has to follow the relevant guidelines for the "distribution" of that product type."

INSURANCE PRODUCT DISTRIBUTION

The insurance sector started its transformation from a government-only industry to welcoming private players by setting up the Insurance Regulatory and Development Authority (IRDA) in 1999/2000.

The industry has grown steadily to about US$250 billion in assets and more than 3 million agents.

However, the predominant model is one of agency rather than broking,

Vishal Kapoor

Standard Chartered

"It may lead to the development of a different economic model in these cities beyond the top 15"

meaning that distribution is done through tied agents. The government-owned Life Insurance Corporation of India (LIC) dominates the business and agency figures with about 70% market share and a network of 1.5 million agents.

Under the bancassurance model, even banks are restricted to acting as agents for only one insurance company in each of the life and non-life insurance sectors.

The product mix is dominated by traditional whole-of-life and investment-linked products. The commissions built into these products were close to 40% of first-year premiums.

A "turf war" with SEBI in 2009 on the issue of whether ULIPs constituted insurance or investment product led to the insurance regulator cutting commissions to one-third of previous levels in 2010.

The agency sales force has fallen 11% last year due to natural attrition as commission cut alienated marginal agents, difficulty in new agent recruitment and stricter termination criteria.

> The asset management industry welcomed the increase in expense ratios, as it would be able to compensate distributors better and hopefully revive flows.

2012 REFORMS

Both the asset management and insurance industries have been under pressure the last three years.

The equity markets have been sluggish, affecting net inflows from retail investors into equity-linked mutual funds and insurance products. The cut in commissions in both industries has also affected flows.

The extremely low penetration of financial products in household savings prompted the Ministry of Finance to hold consultations with players of both industries in early 2012.

SEBI announced its reforms changes in August 2012 including increase in mutual fund expense ratios, launch of direct plans, new class of distributors and Investment Adviser Regulations (discussed below).

The insurance regulator also swung into action after the Finance Minister announced reforms in the product approval process as well as foreshadowing a shake-up of the agency model. The announcement suggested that banks should set up separate subsidiaries that become brokers, forcing them to take responsibility for their advice rather than acting as agents of an insurance company.

HIGHER MUTUAL FUND FEES

Amidst calls to re-institute the en-try loads, SEBI allowed mutual funds to increase ongoing expense ratios – 20 bps to compensate for exit loads being credited back to the fund, 30 bps to encourage inflows from smaller towns, and service tax to be paid by

> It appears that SEBI wants to build a community of investment advisers separately from those who "sell" products for a commission from the product provider.

the investor rather than be paid by the asset manager.

The notification released in September did tweak the terms a bit – it allowed funds to charge an additional 30 bps if new inflows from cities beyond the top 15 cities are at least 30% of gross new inflows in the fund or 15% of the average AUM (year to date) of the fund, whichever is higher. However, such charges will need to be credited back to the fund in case such inflows are redeemed within a period of one year from the date of investment.

The industry welcomed the increase in expense ratios, as it would be able to compensate distributors better and hopefully revive flows.

Says HN Sinor of AMFI: "Yes, the extra fee is justified. Given there is no load in the Indian market, unlike other markets that have 3% to 5% loads, the additional 0.5% to 0.75% is ok."

Adds Sanjay Sachdev of Tata Asset Management: "Whatever SEBI does, I am sure it will look at it from a long-term perspective. As an industry, we need to look at these things from the investor's point of view. Any regulation should have stability as constant change leads to confusion."

Responses in the wealth management industry have been mixed. While some would stand to benefit in terms of higher commissions, they were concerned that higher fees would be harder to sell to investors.

Says Karan Bhagat of IIFL: "Expense ratios are on the higher side. If you look at most funds, the current 1.75% expense ratio will move to 2.3%. The HDFC equity fund, which is the largest in size, would end up at 2.3% in expenses including service tax. The rest will be even higher at 2.3% to 3%. A long-only fund charging this much and consistently beating the index would be a difficult task. If the kind of outperformance that we have seen over the past six to seven years continues, then I don't think clients will mind paying these sorts of fees."

A lot of firms interviewed were positive. Vishal Kapoor of Standard Chartered echoes the sentiments of many: "There are a couple of good measures in the recent regulatory changes, especially those emphasising expansion beyond the top 15 cities. I believe the measures that have been taken will encourage faster mutual fund growth outside the defined top 15 cities. It may lead to the development of a different economic model in these cities beyond the top 15. With better economics for distributing funds, there will be greater focus from the AMCs and distributors in achieving higher penetration in these cities."

However, the introduction of the claw-back clause has led to a lot of debate. In line with the expense ratios being credited back to the fund, if the investment is withdrawn within a year, AMCs have introduced a policy of claw-back of up-front commissions paid to distributors to discourage churning.

Wealth management firms are upset about this. They point out that investors have the right, and advisers have the responsibility, to take profits where valuations might have risen in a short period of time.

They have also been meeting the AMCs to discuss the logistical problems with implementing claw-backs. Banks and large firms pay out the commissions to their RMs as incentives. A claw-back provision means that they can't do this. Further, they can't even recognise the revenue in some cases.

Direct plans

However, the bombshell in the August / September announcements was the requirement for AMCs to rationalise all retail and institutional plans for a given fund into a single expense ratio plan, and offer a "direct" plan with lower expense ratio from 1 January 2013 to cater to investors who approach the AMC without a distributor.

Sinor defends the direct plans. "The idea was slightly different; it was to

All written records relating to the investment advice must be stored for five years. Client grievances must be dealt with adequate processes and any disputes can be resolved through arbitration.

give an option to the investor. The whole discussion came around from the insurance industry, which offers online option at a lower cost. So the discussion was why couldn't mutual funds do the same? We also have a younger generation now who would like to use technology. Maybe they want to use for lower cost. My personal view is that only a small percentage of people will go direct."

Again, the response from the wealth management industry has been mixed.

IFA blog sites have been flooded with negative comments. IFAs insist that their larger investors will get advice from them, but then execute directly. Even if they execute through them, investors are free to switch later and get pay a lower expense ratio. The IFA firms that focus on the corporate segment would be most affected.

Banks and larger distributors seemed to be more accepting of the direct plans. Indeed, some welcomed it as it would make the investment advisory proposition, under which they charge the client a fee, more viable.

Says Bhagat: "We don't even know if it's optional or compulsory. Even if it's optional, the large fund houses would have come through as there would be too much negative publicity if they don't. We will have to adjust our business accordingly…. Regarding fees, you could have a 70-bp to 80-bp gap so the fees would end up being around 1.75%. Even at 1.75%, it is not going to be easy on a post-tax basis to outperform."

Investment Adviser Regulations

Further, to ensure that its intention of managing conflicts of interests is clearer, SEBI also issued draft regulations for regulating "the act of investment advice".

It appears that SEBI wants to build a community of investment advisers separately from those who "sell" products for a commission from the product provider.

The advice can cover any type of financial product.

While it's not clear whether the draft Investment Adviser Regulations will be issued in current form, these regulations, when issued, will regulate the, hitherto unregulated acts of investment advice, separate from the distribution of various financial products.

These regulations are significant as other more developed markets have been debating the distinction between "advice" and "distribution for years. While some markets have tackled this issue with the restricted use of the word "independent" and stringent disclosure requirements, the regulator dealt with this issue by separating the acts of distribution and advice, subjecting them to different regulations.

Investment advice has been defined as advice relating to investments, whether written or oral, and will include financial planning.

The draft regulations spell out that anyone wishing to give, or holding out to give, personal investment advice needs to be registered with SEBI, except those who are already regulated for the product distribution, or whose advice is incidental to their main job such as the media, lawyers, accountants, etc.

Hence, the distribution of stocks by brokers, insurance policies by insurance agents/brokers, mutual funds by mutual fund distributers, and pension funds by pension advisers is not covered by these regulations as they are already covered by existing regulations, by the same and also by different regulators.

The proposed regulations lay down relatively stringent eligibility criteria as compared to international practice, including:

- **Qualifications** – professional qualification or post-graduate degrees / diplomas in relevant subjects from a recognised institution or a graduate in any discipline with five years' experience in financial activities

- **Certification** – certification on financial planning, asset management or investment advisory provided by the National Institute of Securities Markets (NISM) or Financial Planning Standards Boards (FPSB), or similar such certification accredited by NISM

- **Capital adequacy** – net worth of INR 25 lakhs (around US$50,000) for body corporates or INR 5 lakhs (around US$10,000) for individuals and partnerships

The general obligations and responsibilities are also amongst the highest standards internationally as they include acting in "fiduciary" capacity and disclosing all actual and potential conflicts of interests. Investment advisers are not to engage in unethical practices, nor enter into transactions on own account that are contrary to the advice given to clients. They must also follow a code of conduct included in the draft regulations.

In line with global practice, the regulations specify that advisers must follow the Know Your Client procedures, including obtaining necessary information including details about income and existing assets and liabilities. Interestingly, the guidelines for the risk-profiling process are remarkably detailed, quite similar to UK guidelines.

So they must be robust, ensuring the tools used are fit-for-purpose and any limitations recognised and mitigated, the questionnaires do not contain complex language or have any leading questions, and any answers are not attributed "inappropriate weights".

Investment advisers must ensure the advice is "suitable and appropriate to the risk profile", be based on a robust and flexible process for selecting investments, and have "reasonable basis" that the recommendations meet the clients' investment objectives, the client is able to bear the risks and has the necessary experience and knowledge to understand the risks.

The disclosures to clients include key features of the product, drawing attention to warnings and disclaimers. The investment adviser must also disclose all material information about itself including terms of the advisory service, disciplinary history, affiliations with other intermediaries, and "any other information as is necessary to take informed decisions".

They must also disclose all considerations and rewards including any referrals for recommending other intermediaries. They must also disclose their own holding or position on any products they recommend.

Interestingly, the regulations don't expressly prohibit commissions. All written records relating to the investment advice must be stored for five years. Client grievances must be dealt with adequate processes and any disputes can be resolved through arbitration.

The most important clause that affects the status quo is the one that states investment advisers cannot provide execution services although they can refer clients to a related party, such as a different division of the same organisation, for execution services at arms' length and on a non-obligatory basis.

INDUSTRY RESPONSE

The wealth management industry welcomed the draft Investment Adviser Regulations. A number of CEOs interviewed for this Guide confirmed that their firms already provide advisory services.

The draft regulations had incorporated some of the feedback the industry had given on the concept paper issued in September 2011, which prevented an investment adviser from receiving commissions. Since the primary source of revenue for most firms was commissions they were concerned last year. But since this restriction was taken out in the draft, they were more relaxed.

Says Bhagat: "If you see most financial markets, such as in Dubai or Switzerland, they don't allow you to double dip. There's nothing wrong with it. There are clear disclosures on what you make on the other side. The new regulations allow for separate divisions…. The current portfolio management guidelines mandate disclosure that you will make commissions… you just don't have to specify quantum. If the current regulations specify quantum, that's the only change."

However, the industry has still been unclear on the implications of a few clauses, and has been considering seeking clarification from SEBI. There appears to be confusion not only about minor implementation issues, but also about the broad intention including scope and commissions.

Explains Kapoor: "On the aspect of advisory guidelines, I think the advisory industry is still looking for some more clarity. The intent has been well noted, and execution specifics are being discussed. The industry does recognise that it is a step in the right direction as it is now a large industry to have a formal set of rules to play by and we also hope that in time there will be better dialogue between the advisers who are being regulated and with the SROs as well as the regulator."

> The question is: can investment advisers receive considerations from product providers related to specific securities, if appropriately disclosed?

At Hubbis roundtables with various wealth management participants, it became clear that the confusion goes to the very intention of the regulations – some participants wondered whether it applies to entities holding out to be advisers, or the "act of advice".

While the act of advice has not been defined, the duties outlined for investment advisers are similar to the responsibilities that mutual fund distributors have to do currently such as client risk profiling and ensuring client suitability. Hence, it may be possible for mutual fund distributors, including banks, to continue to be distributers and not be covered by the regulations.

The draft mentions banks and corporates can offer investment advice services through separately-identifiable departments or divisions (SIDDs). But it's not clear whether the definition of adviser will be restricted to the SIDD or the overall bank or entity.

At a practical level, are there any restrictions of persons from these SIDDs meeting clients with someone from a related party product distribution department? Does the restriction of not entering into transactions on own account contrary to the advice given to the clients applicable to the SIDD or the overall entity?

Banks have been wondering whether their RMs could offer transaction support for investment advisory while continuing to act as one point of contact for customers for all their other banking needs.

Some banks wondered whether their the advisory team of investment counselors, portfolio counselors, product and the research team could be separated into the SIDD, but were not sure if this would place any restrictions on the other banking activities they carry out. Banks were also worried about the implications of the requirements to offer advisory services in fiduciary capacity, as the connotation includes elements of discretion.

Another significant issue is one relating to commissions. The memo mentions that investment advisers may charge fees to the client, and disclose considerations, presumably commissions if disclosure is necessary, if the client chooses recommended securities. Hence, can investment advisers receive considerations from product providers related to specific securities, if appropriately disclosed?

Hubbis has also spoken with overseas industry participants who note that some of the provisions are stricter, and untested, even in developed markets. For example, the requirements relating to advisers acting in a "fiduciary" capacity, disclosure of potential conflicts of interest, and engagement in "unethical" practices. Experts note that the guidelines for risk profiling are untested anywhere in the world.

A STATE OF FLUX

Clearly, the wealth management industry is in a state of flux. This year saw regulatory changes or announcements for distribution of mutual funds and insurance products, as well as for investment advice. Sinor welcomed the draft but surmised that it was ambitious. "People around the globe are averse to paying fees…. There will not be more than 500 to 1,000 advisers. Most people will remain distributors. However, since the distribution industry is up in arms about this, I don't think they will come out very soon."

Grant Kennaway, head of fund research for Morningstar in Asia Pacific, offers a ringside view of the regulatory changes by comparing them to developments elsewhere: "In developed markets like the US, Australia or Canada, where mutual fund penetration is already high and markets are already mature, removing commission will prevent some unfortunate experiences from happening. But in this market, although it makes sense, maybe they have moved too early. Maybe the regulator has taken a long-term view. Globally, there are still commissions on insurance; if the regulator or the government takes a view that mutual savings and saving products are crucial to the future of the country, that's another place where the commissions are available as well. It's a global trend and whichever market Morningstar is looking at, the regulators are ruthlessly looking at the commission on sales." ■

Co-published with Religare Macquarie

FINANCIAL PLANNING IN INDIA ON A TRAJECTORY

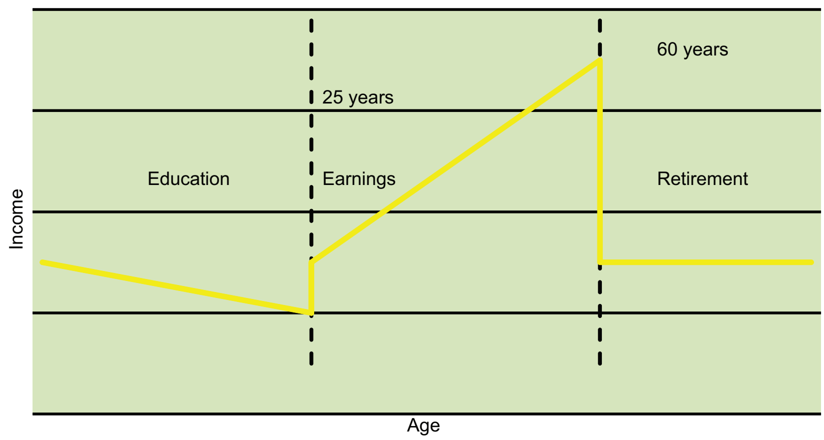
Indian investors, unlike those in most other markets, are yet to grasp or accept the timeless principles of investing through a proper financial or investment plan. Herein lays the overall opportunity. This article describes why financial planning is a necessary wealth management tool.

"The question isn't at what age I *want to retire, it's at what income." (George Foreman)*

Isn't this the essence of what we all desire and strive for? We all have new and evolving – sometimes unlimited – wants and needs. New and more adventurous aspirations evolve as one progresses through life's journey.

We all know that the number of earning years is limited and that many of the goals of one's life are financial in nature. So why then do we allow ourselves to fall into the trap of thinking all will be okay and not plan for a financial future? To reap the benefits of hard work and to ensure accomplishment of one's goals, proper planning through a certified wealth adviser almost becomes a necessity.

Human earning cycle



A few generations ago, the thought of saving for retirement was unheard of.

But as Indian families move to a nuclear and independent existence, the need for financial independence and carefree retirement years becomes a critical evolutionary exercise.

UNDERSTANDING FINANCIAL PLANNING

Financial planning is a process through which one can chart a roadmap to fulfill the financial goals of one's life.

It enables one to draw out the family's cash flow of all current and future incomes, and all of the current and expected expenses.

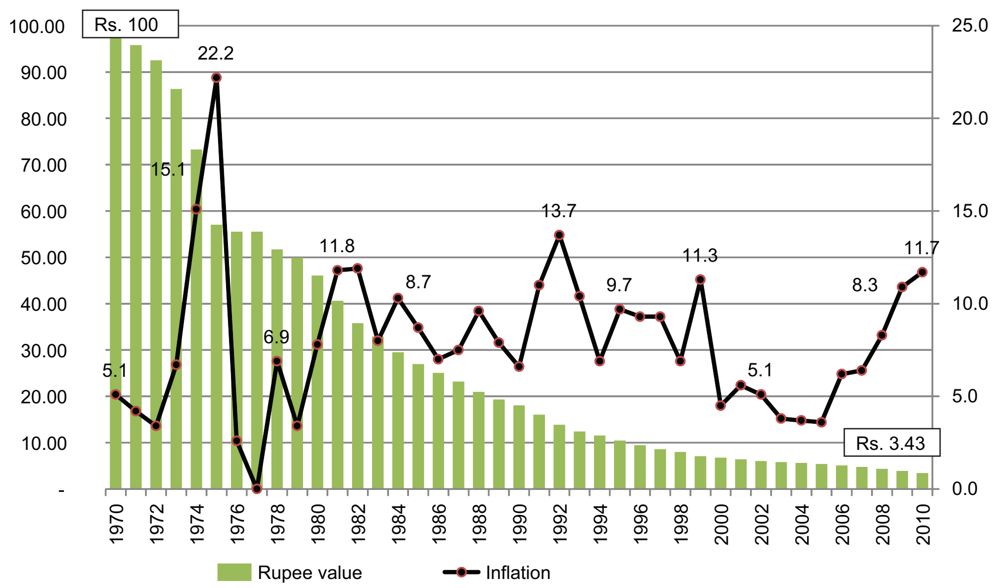
It allows one to set realistic goals for the family and outlines a roadmap on how to achieve them. It evaluates the current financial situation, outstanding liabilities and insurance position, and matches those against the future financial goals.

Financial planning also helps to ascertain need gap analysis and chalk out a plan to reign-in expenses and outstanding liabilities in a more manageable and structured manner. Further, a comprehensive financial plan assesses options for succession planning to ensure that the family's financial security is maintained, even at the time of there being grave eventualities and contingencies.

It's important to plan for a long life but also be prepared for every contingency in life, such as an unfortunate death or disability can bring about on a family's financial health and goals.

Financial planning also helps to ascertain need gap analysis and chalk out a plan to reign-in expenses and outstanding liabilities in a more manageable and structured manner.

Inflation



APPLYING FINANCIAL PLANNING

A good wealth manager should stress-test the proposed plan for various scenarios to ensure adequate margins of safety are built into the plan. Financial planning involves the following ongoing process:

- Establish goals and objectives
- Review the current financial situation
- Develop a strategy to meet needs
- Implement the strategy
- Assess insurance and succession requirements
- Review goals and financial status on a periodic basis

This is an evolving process and therefore reviewed on a regular basis.

Consider this: while we all know the impact of inflation on cost of goods and services today, very few link it to the purchasing power parity of the same goods and services in the future.

- Assuming a monthly expense of INR 50,000 in today's terms, the total expenses in retirement could be approximately INR 5 crores, assuming 30 years in retirement

- Or consider this: an income of INR 50,000 in 1992 is equivalent to only approximately INR 13,000 today's value terms

So would an income of INR 50,000 be sufficient to meet the same level of lifestyle today as was possible 20 years ago?

The answer holds the key to the importance of financial planning.

Bu understanding inflation it is possible to see that the purchasing power of INR 100 has eroded to just INR 3 in the last 40 years!

An investment portfolio must therefore generate positive real rates of return after factoring in inflation and taxes. A negative real rate of return will erode wealth plus the chances of achieving future financial goals become limited.

For example, a fixed deposit earning an interest rate of 10% seems really high, on the face of it. However, on closer evaluation, after inflation and taxes this investment provides a return of -0.93%.

Evaluating the risk profile and building a portfolio that implements long-term asset allocation strategies to achieve a real rate of return in order to diminish the effects of inflation on savings is one of the key deliverables of a sound financial plan.

> A disciplined approach to savings and investments – taking into consideration the financial objectives, liquidity, investment horizon and the investors' risk appetite – helps to build wealth and net worth in a manner that will not only meet future financial goals, but will also set the roadmap to achieving true financial independence.

A disciplined approach to savings and investments – taking into consideration the financial objectives, liquidity, investment horizon and the investors' risk appetite – helps to build wealth and net worth in a manner that will not only meet future financial goals, but will also set the roadmap to achieving true financial independence. A typical trap investors fall into is to think financial planning is as easy as doing a cash-flow analysis.

Financial planning requires discipline; choice of appropriate investment assets to meet not only current financial needs but also to fulfill future needs; an acknowledgment that certain goals may need to be sacrificed – and if that is not possible – then certain current lifestyle behaviours need to change in order to meet the financial goals in the future; and most importantly, a wealth adviser who is then able to assist with the execution of the plan against research-backed investment tools. ■

IFA: DHRUV LALIT MEHTA

With assets under advice of around INR 2100 crores, Dhruv Lalit Mehta is one of the larger independent financial advisers in the Indian market.

Even though Mehta has recently been in the spotlight as representing the mutual fund distribution industry in consultation meetings with SEBI and the Finance Ministry in his role as the founder and chairman of FIFA, he hadn't even thought about financial advisory as a career option when starting his career as a chartered accountant.

"In the mid-1990s I was managing the corporate treasury of a firm," says Mehta. "When the firm went public, I started managing the personal assets of the promoter."

He started out on his own in 2003, continuing to advise the promoter's assets, and quickly attracted a similar high net worth investor (HNI) clientele.

While his chartered accounting background helped, "a steep learning curve was required," he explains, "as investing is a much broader area requiring in-depth understanding of maths and behavioural science, and the ability to apply those concepts in the real world."

While he may have access to a lot of fund managers today, that wasn't the case when Mehta started his business.

> Being an IFA has its advantages and disadvantages. Mehta believes his clients trust him because they see the same person year after year, and they like his value proposition.

One should equip oneself with what is happening in the world and how that affects different asset classes…. It is [also] very important to connect with people who are very successful. Even successful clients can teach you a lot.

Dhruv Mehta

Dhruv Mehta

So he would attend a lot of conferences organized by asset management companies, to network with people from whom he could learn.

Being an IFA has its advantages and disadvantages. Mehta believes his clients trust him because they see the same person year after year, and they like his value proposition.

"One of the biggest realisations for me was that while I need to get good returns for my clients, they are not looking for the highest returns," he says.

Adds Mehta: "They are looking for the best I can, ie. my value proposition."

Mehta admits that to service the HNI segment, one needs both breadth and depth, and that there are areas that he is not expert in, such as real estate.

But he believes he has to give confidence to clients that he has more knowledge on a particular subject. So he reads widely to keep himself abreast of major developments around the world.

Reading is a key tip he would give to up-and-coming IFAs. "One should equip oneself with what is happening in the world and how that affects different asset classes," he says.

Another tip is networking, he adds: "It is very important to connect with people who are very successful. Even successful clients can teach you a lot."

On the business side, Mehta suggests that IFAs should collaborate with each other: "The way the regulatory framework is developing, there is going to be pressure on intermediation. If you are in the intermediation business, you will need to either build scale or a niche." ■

Firm profile

IFA: PLAN AHEAD WEALTH ADVISORS

Established in 2003, Plan Ahead is the business partnership of life partners Vishal Dhawan and Shalini Dhawan. Together they have built a boutique financial planning practice with a team of 12.

Previous to founding Plan Ahead, Vishal Dhawan was a banker, having spent close to seven years at a private bank and a multi-national bank, and Shalini Dhawan has worked for six years, first as a financial analyst with a multi-national and subsequently with a consulting firm.

Plan Ahead's value proposition is to be client centric. Says Dhawan: "To build a sustainable business model one needs to client-centric rather than putting clients around a product. The focus should be on adding value in at least one of two ways – either adding time to a client's life by holistically taking over the management of his or her finances,

"Plan Ahead must be adding value to clients as the business is profitable."

Vishal Dhawan
Plan Ahead Wealth Advisors

The opportunity is significant for IFAs as there is a greater movement globally towards wanting more customised and personalised solutions that are delivered through objective advice.

Shalini Dhawan

Plan Ahead Wealth Advisors

or adding meaning to their finances by helping him or her better understand what their wealth can do for them at various critical transitions in life."

If neither of these is happening, the adviser-client relationship is unlikely to be truly long term, adds Dhawan.

Plan Ahead must be adding value to clients as the business is profitable.

"The opportunity is significant for IFAs as there is a greater movement globally towards wanting more customised and personalised solutions that are delivered through objective advice."

"A large number of clients today are less focused on the size of the advisory firm, and more on the objectivity and appropriateness of the advice."

However, Dhawan admits that scalability of an IFA model is a challenge, given that the biggest stress point for an IFA firm is the ability to retain people. And the business model requires management to constantly train fresh talent.

Yet it becomes challenging to find the time to train people.

"Both principals and teams are so busy that formal training becomes second priority to others tasks that seem to be more important."

"Being a small firm, if I put too much pressure on my employees, they will leave. Hence, it becomes critical to handle both the shorter-term needs of the business of quick response times and also the longer-term training needs of the business. "

However, more than technical training, Dhawan believes in softer skills: "The consumers want the advisers to connect to them. They want the advisers to understand them beyond the portfolio statement. They also want advisers to understand them and their life goals at a significantly deeper level."

Co-published with Edelweiss

PRIVATE BANKERS - WHAT DOES IT TAKE?

Being a top-notch private banker is not a cake-walk, especially with an ever-changing global financial landscape. While getting oneself technically updated may seem the first challenge, private bankers require a lot more skills to turn their practice profitable and sustainable.

Edelweiss Global Wealth Management is one of the fastest-growing wealth management firms in India and a part of the diversified group, Edelweiss Financial Services.

Edelweiss Global Wealth Management's value proposition to "new age" entrepreneurs is to offer them a comprehensive multi-asset class advisory platform with a 360-degree view on their balance sheet – both personal and enterprise.

Although Edelweiss Global Wealth Management is one of the newer entrants to private banking in India, it has already laid out a robust learning and development framework to ensure its private bankers or financial advisers are top-notch in the industry.

The attributes it seeks from private bankers complement the common traits associated with its clientele:

- Managed risk-takers
- Opportunity seekers
- Stretch the rupee
- Control
- Shorter investment duration
- Impatient

According to Edelweiss Global Wealth Management, apart from a deep understanding of economics and strong financial acumen, one needs to have the following attributes:

- **Integrity** - As private bankers deal with money, integrity is paramount. Integrity is what drives trust and as private bankers developing the client's trust is of prime importance. Being reliable, consistent and discrete are important factors that go into building trust-based relationships.

- **Client orientation** - Another important quality for the private

Edelweiss Global Wealth Management is one of the newer entrants in the realm of private banking in India, it has already laid out a robust learning and development framework to ensure its private bankers or financial advisers are top-notch in the industry.

banker is to think on behalf of the client, ie demonstrate empathy. Tough markets are the litmus test for this quality. "If you do what is right for your client, you are doing what is right for the organisation" is one of the service mottos for Edelweiss Global Wealth Management. If a long-term practice needs to develop, sticky clients are crucial.

- **Drive and ambition** - This trait is what is referred to as the "fire in the belly" or the "spark within". In many countries like India, wealth management is still a latent need. Rejections are numerous and consistent, and ambition is the only thing that drives top-notch private bankers. Do you stop till you hit the wall, or when the wall pushes back! The ambition to succeed helps in building resilience and encourages an ability to think out-of-the-box solutions. These in turn help in forging relationships that stand the test of time.

- **Resourcefulness** - Private bankers are solution-seekers for clients. Being resourceful ensures that all functions of the organisation work for the clients, which in turn drives a private banker's productivity. Organisations tend to get straight-jacketed and function likes silos, being resourceful helps bridge these distances in between. More importantly being resourceful leads to effectively leveraging the organization's strengths which over a period of time build into the core competence of the business.

- **Relationship building** – Being at the customer facing end of the supply chain in wealth management, the success of a private banker's career depends to a large extent on their ability to build and manage relationships. Professionally they are called upon to go beyond the boundaries of work to engage with the client and over a period of time move from an "expert for hire" role to a "trusted partner" role. Building relationships is a clear indicator of a person's ability to eventually become a successful private banker. In all assessments, the financial advisers are tested and trained on their relationship-building abilities in multiple ways to ensure their success.

- **Problem solving** - This is considered to be the trait that is indicative of leadership potential in line managers. At Edelweiss Global Wealth Management, we believe that when confronted with a problem, the ability to think through and come up with alternatives is a hallmark of a successful private banker.

- **Intra-preneurship** - At Edelweiss Global Wealth Management, private bankers are encouraged to run their practice as entrepreneurs and are empowered to plan their business, goals, vision and direction for growth. However, this requires them to responsive with responsibility. Private bankers need to be proactive, self-driven and constantly adapting to market scenarios.

- **360-degree perspective** - private bankers at Edelweiss needs to assimilate solutions beyond wealth needs and look at enterprise or business requirement. This is especially important for Indian entrepreneurs as there is a strong confluence between both these needs. ■

INVESTMENT BANK: EDELWEISS

Similar to its tag line – "ideas create, values protect" – Edelweiss comes across as a young entrepreneurial financial services group with innovative ideas.

Edelweiss founders Rashesh Shah and Venkat Ra-maswamy set up the group in 1995 after a diverse career in the Indian financial services industry.

The group has businesses in capital markets, asset management, insurance, credit and housing finance.

And the global wealth management business is part of its retail capital markets group.

Anshu Kapoor set up the wealth division in 2010, bringing with him years of experience earned at Merrill Lynch and HSBC Private Bank, with the aim of leveraging the group's platform to offer innovative solutions.

The firm aims at owners and self-employed clients with a minimum net worth of INR 50 crores and minimum investable amounts of INR 5 crores. The average client portfolio is around INR 10 crores.

The firm has about 30 relationship managers with around INR 3,000 crores under advice, and it also manages about US$100 million of assets under its advisory platform on which it earns fee income.

"The firm has about 30 relationship managers with around INR 3,000 crores under advice, and it also manages about US$100 million of assets under its advisory platform on which it earns fee income."

While the firm looks at hiring experienced private bankers to provide a strong foundation to the business, Kapoor also believes in nurturing talent as a differentiating factor in the long run.

Anshu Kapoor

Edelweiss

While the division does not disclose its revenues separately, Kapoor claims it is profitable.

The firm aims to provide a value proposition to clients through addressing both sides of the balance sheet and spotting trends, and then monetising the next opportunity.

Says Kapoor: "Our value proposition to clients is the ability to offer the entire Edelweiss Platform. This includes investment banking, institutional research, wholesale asset management and financing capabilities apart from our proprietary treasury management capabilities."

Adds Kapoor: "We believe our competitive edge lies in product innovation and the ability to manage risk for our clients especially during volatile market conditions."

The firm's innovative approach generally is also reflected in its talent strategy.

While the firm looks at hiring experienced private bankers to provide a strong foundation to the business, Kapoor also believes in nurturing talent as a differentiating factor in the long run.

He set up the Edelweiss Private Bankers Program along with a management trainee programme.

He claims these initiatives have worked well for the firm.

On the topic of hiring from related sectors, Kapoor admits: "We have had limited experience in hiring from talent pools within the realms of the BFSI sector, as we believe their understanding of capital markets, access to UHNIs and ability to manage assets seldom justify the remuneration these candidates seek." ■

INVESTMENT BANK: AVENDUS

Founded in 1999 to provide advisory services for mergers & acquisitions and growth funding to mid-sized companies, Avendus has expanded into institutional equities, alternative asset management and wealth management.

Since industry veteran Nikhil Kapadia left his role as head of Deutsche Bank's Indian private wealth management franchise to join Avendus and start up its wealth business in 2010, he says he is happy with its progress so far.

The firm has INR 1,600 crores in assets under advice across 112 clients, with an average portfolio size of US$2 million.

> Avendus' approach to them has been to offer what entrepreneurs would appreciate: innovative niche products.

He points out that the more important figure of return on assets at 60 basis points puts the firm amongst the highest in the industry.

Given the difficult market conditions and hence the predominance of lower-returning fixed income assets in portfolios, he is quite comfortable with his strategy, and hopes to achieve cash break-even next year.

With the group providing M&A advisory services to mid-sized entrepreneurs, his team has a steady source of wealth portfolios.

Avendus' approach to them has been to offer what entrepreneurs would appreciate: innovative niche products.

These are things that he says larger banks tend not to do, or won't do.

He adds that if he were a client, he would try out the "new kid on the block" with a small share of wallet to see how it performs against the more established providers.

The niche areas the firm has focused on are private equity and real estate.

Munish Randev, the firm's head of product and advisory, doesn't mind approaching product providers for a change in terms if he doesn't think they would suit his clients.

Randev negotiates not only with third-party providers but also with the firm's in-house private equity fund for higher fee hurdles, profit share and better governance.

Randev is also passionate about real estate. He's even built a model to rate real estate projects –for use as shelter or for investment purposes.

The model scores real estate opportunities on 75 to 80 parameters with weights customised to the use. By applying the private equity approach to real estate, he then negotiates better terms with developers.

> Avendus leverages the product solutions not only in the domestic market but also to appeal to non-resident Indians through the firm's overseas offices in London and New York. It also partners with overseas banks and external asset managers as their India expert.

Nikhil Kapadia

Avendus

Avendus leverages the product solutions not only in the domestic market but also to appeal to non-resident Indians through the firm's overseas offices which it has in London and New York.

It also partners with overseas banks and external asset managers as their India expert.

The innovative approach to product, combined with a very engaged team and open communication, offers a very attractive environment for talent.

Given the sophisticated clientele and small team size, Avendus' talent strategy relies on hiring very experienced relationship managers. ■

Firm profile

INVESTMENT BANK: AMBIT PRIVATE WEALTH

Ambit Private Wealth started operations in 2010. It is one of the major verticals of Ambit Capital, the brokerage arm of Ambit group, established in 2006, primarily dealing in securities trading and now offering services like securities brokerage, equity research, institutional broking, private client group, private wealth management and portfolio management services.

Expanding from its core business of investment banking, started in 1997 by Ashok Wadhwa, into newer areas, Ambit currently operates through six lines of businesses is on its way to becoming one of the most unique and value-driven firms in India.

Sutapa Banerjee, chief executive officer of the private wealth business, is an experienced professional who previously set up and led ABN AMRO's private banking business from scratch.

She took it to over US$1 billion in AUM. In 2007, she was named as one of Institutional Investors' global "Rising Stars of Wealth Management".

And she seems to be repeating some of the success with Ambit Private Wealth.

The firm has already been voted as the third-best private bank in India in the 2012 Asiamoney polls, despite it still in only its second year of operation with US$165 million under advice across 180 client families.

The firm targets a niche client segment with US$3 million to US$4 million in investable assets, and caters to them with tailored solutions.

"When you go to a typical Indian client and say that we do a holistic wealth management, they ask is there anything that you do different," says Banerjee, explaining that there is a need for a broad service offering along with a differentiated strategy.

At Ambit, the offering includes not only mutual funds and securities broking, but also lending and wealth planning.

"The offering includes not only mutual funds and securities broking, but also lending and wealth planning."

However, it's the approach that makes the difference. Banerjee understands that.

"HNIs have made their money over a period of time, so when they come to you they are not coming for spectacular gains," says Banerjee.

"The whole idea is that they don't want to erode the capital that they built up over a period of time and they want reasonable returns."

Hence, the open architecture investment platform covers protection and growth strategies that get applied to whatever the client mandates demands.

"If the client has given you a mandate to achieve 18%, then stick to that mandate since the latter determines how the portfolio is run," says Banerjee.

"We also have a couple of equity strategies that are both unique and have performed very well even in the highly-volatile market conditions that have been prevalent in the last couple of years."

Sutapa Banerjee

Ambit Private Wealth

> "This is still a new business – barely two years old.... By nature this is a high-gestation business. It will take time to reach break-even and one needs to have the patience to build this business."

In terms of her talent strategy, Banerjee says she looks at experienced lateral hires who have done at least a stable stint of three to four years in one organisation.

Such a person comes with a far greater credibility compared with someone who has moved every 18 months.

With a total staff of 26, the model is to have fewer, but more experienced, senior relationship managers to service a niche set of clientele.

When asked about profitability, Banerjee points out that it is still a new business – barely two years old.

Plus, by nature this is a high-gestation business, explains Banerjee.

"It will take time to reach break-even and one needs to have the patience to build this business."

Feature article

ROLE OF RATINGS

Star ratings are universally-accepted indicators of grading systems. They tell the user instantly about the conclusion of detailed analysis – whether they are referring to hotels, restaurants or movies. Star ratings have also come to dominate the world of retail mutual funds.

For firms like Morningstar, its star ratings have become so influential in the US, that there are academic and industry studies on their impact on mutual fund flows. But what do the star ratings actually mean? How are they derived? Who pays for them? How should investors use them? We look at the role of mutual fund star ratings in India.

STAR RATING METHODOLOGIES

The oldest provider of star ratings in India is Value Research, a private firm based in Delhi. Founder Dhirendra Kumar established the firm in the early 1990s and today his name is synonymous with mutual funds.

The Value Research Fund Rating is a purely quantitative risk-adjusted return calculation. According to the firm's website, the rating gives a quick summary of how a fund has performed historically relative to its peers; the assessment does not reflect Value Research's opinion of the future potential of any fund.

The firm classifies each fund into various categories to be able to calculate relativities. Each category must have a minimum of 10 funds for it to be rated.

For equity and hybrid funds, the fund ratings for three and five periods are combined to give a single assessment of each fund's risk rating vis-à-vis other funds in each fund category. For debt funds, the fund ratings are based on 18-month weekly risk-adjusted performance, relative to the other funds in category.

Morningstar, the global leader in mutual fund ratings, launched its Indian business in 2008. The Morningstar Star Rating is purely quantitative based on a weighted average of risk-adjusted returns over three-, five-, and 10-year periods. After calculating the risk-adjusted returns with a defined category, Morningstar sets the distribution of funds across the rating levels to form an approximate bell curve

"Star ratings have a long history," says Grant Kennaway of Morningstar. "They came into the market when there was nothing. Morningstar brought in a rating that looked at returns, risks and also costs. Our studies have shown that is a predictive factor. Morningstar five star-rated funds do better than category averages.

Local credit rating houses CRISIL and ICRA, subsidiaries of Standard & Poor's and Moody's respectively, also provide mutual fund ratings, though they are called "rankings".

"Unlike most other ranking models that are purely based on returns or NAV, CRISIL Mutual Fund Ranking uses a combination of NAV and portfolio-based attributes for evaluation."

CRISIL's fund ranking framework provides a single-point analysis of mutual funds, which takes into consideration all factors such as risk-adjusted returns, company/industry concentration, liquidity, asset quality and asset size," explains Jiju Vidyadharan, director, funds and fixed income research for CRISIL.

The CRISIL Mutual Fund Rankings are assigned on a scale of 1 to 5, with CRISIL Fund Rank 1 indicating "Very good performance". In any peer group, the top-10 percentile of funds is ranked CRISIL Fund Rank 1 and the next 20 percentile are ranked CRISIL Fund Rank 2.

ICRA provides fund management quality ratings on the overall quality, governance process, and fund management expertise of the AMC rated. According to the firm's website: "For AMCs, ICRA ratings are a credible means that can be used to highlight their investment management characteristics. The ratings also provide investors with a useful benchmark to differentiate among AMCs. ICRA ratings however are not intended to comment on the future performance of the schemes or funds being managed by the AMCs rated."

In summary, different rating houses use slightly different methodologies to arrive at star ratings or rankings. However, all of them rely on past performance – which is ironic, since regulators around the world make it mandatory in the industry to warn investors that "past performance is not indicative of future performance".

Jiju Vidyadharan
CRISIL

"CRISIL Mutual Fund Ranking uses a combination of NAV and portfolio-based attributes for evaluation"

LIMITATIONS OF QUANTITATIVE RATINGS

The rating houses do realise the limitations of quantitative ratings. There are logistical limitations of minimum three years' performance history, minimum fund size and having enough funds in a category.

More importantly, though, there are question-marks over the efficacy of ratings which are based on historical performance.

"Different rating houses use slightly different methodologies to arrive at star ratings or rankings. However, all of them rely on past performance."

Jignesh Shah
Sarasin-Alpen

"Research houses like any other business proposition pass through a similar evolution phase"

Claims Vidyadharan: "Over the long run, CRISIL Rank 1 funds, when rebalanced quarterly, have outperformed lower-ranked peers and benchmarks." He explains that the firm "continuously reviews the ranking criteria based on market dynamics and industry feedback. We also back test the performance of funds that are included in our ranking universe."

There is also the practicality of using ratings. Rating houses update their ratings on a regular basis. While the longer time periods should ensure some stability, Vidyadharan cautions that "investors must regularly track CRISIL Mutual Fund Ranks in order to take informed investment decisions."

Morningstar faced criticism on its quantitative ratings for years. When it acquired local rating businesses in Australia and Canada, where the wealth management markets preferred to use qualitative ratings, it allowed the local businesses to continue to provide qualitative commentary. It eventually launched a qualitative methodology globally in 2011.

Explaining the reason why Morningstar has two rating systems, Kennaway says: "(Star Ratings have) lots of flaws – they are backward looking. We've taken a view that there are a lot of other factors. That's why we have our Analyst Ratings. Star Ratings can be used to narrow down the universe. If they want to narrow it down further, they have the Analyst Ratings. The reports are written primarily for the advice market, but they are equally applicable to retail investors."

"Running a qualitative rating process is challenging in emerging markets."

Morningstar's 110-strong global analyst team rates funds on the "five Ps" it believes are crucial to predicting the future success of funds: people, parent, process, performance, and price.

The Morningstar Analyst Ratings are assigned on a five-tier scale running from gold to negative. The top three ratings, gold, silver, and bronze, all indicate investment grade.

The difference between them corresponds to differences in the level of analyst conviction in a fund's ability to outperform its benchmark and peers through time, within the context of the level of risk taken.

When asked about the point of having two rating systems, Kennaway says Morningstar will continue to run the two in parallel as they both have a role to play. However, their focus is now on the Analyst Ratings. He can't be sure that in 20 years time the Star Ratings will still exist. His advice was that investors should use both: the quantitative Morningstar Star Ratings as a screen to filter the universe, and the qualitative Analyst Ratings to avoid "blow-ups".

QUALITATIVE RESEARCH

Prateek Pant of RBS Private Banking welcomes the launch of qualitative ratings in India. "There are a few research houses, predominantly international, which have been proactive in porting their international research methodologies with minor tweaks to suit the domestic fund industry. Many local research houses still thrive on the tried-and-tested return-based rankings, which to our mind have their set of pitfalls."

Qualitative analysis when selecting funds is common in the institutional space. Global institutional investment consulting firms like Mercer and Towers Watson use qualitative analysis when selecting asset management firms in developed markets for institutional investors like pension funds and sovereign wealth funds.

However, such analysis becomes an issue in emerging markets where managers do not have clearly-defined investment processes.

Kennaway agrees that running a qualitative rating process is challenging in emerging markets like India. "People are new to qualitative research. We run the same global process but people here are getting used to having to open up their bonnet and talking about their process. The process is very professional and consistent with what we do offshore, but the objectivity of the analysts and the frankness with which they write reports can be seen as confronting. Our objective is to represent the end-investor, so we if see issues with the parent or we don't like the way the team is being run, and we comment about it, culturally people find it confronting."

Prateek Pant
RBS Private Banking

"International research set-ups can bring a lot to the table"

Comparing Indian managers to global managers, Kennaway says that Indian managers find it a bit hard to articulate their process and often it's because it's not formulaic. "It's far more reliant on people than process," he explains.

Qualitative ratings have their skeptics, too. Whether done by rating houses or by wealth management businesses, qualitative analysis is subjective. While there are numerous examples of subjective calls in the industry, from macro-economic forecasting to company-level earnings modeling, these are usually guided by analysis of demand / supply fundamentals of the economy, industry or company's products and services. In the case of asset management, the analyst tries to predict the "skill" of the fund manager in outperforming their peers. Looking at the current portfolio of liquid securities doesn't help much since it could change the next day.

> "Some senior people in the industry privately question the value of ratings. They don't have a high opinion of the ratings, nor of the business model adopted by the rating houses."

BUSINESS MODELS AND TRANSPARENCY

CRISIL and ICRA confirm that their rankings are "suo moto" exercises; rankings are freely-available to investors on their respective websites. However, they also confirm that their rankings are no longer being used in advertising by mutual funds following an amendment to the mutual fund regulations in February 2012.

The regulations mention that mutual fund advertisements "shall not contain any testimonials or any ranking based on any criteria". Prior to this change, mutual funds used to mention rankings and awards by rating agencies quite extensively.

Value Research also makes its ratings available freely on its site and through the media. However, industry practitioners point out that the free availability has enhanced the brand value of Value Research which then monetises it though advertising on its website and publications.

Morningstar commercialises its fund research by including ratings and also reports in various products and services, and through licensing its intellectual property.

Says Jignesh Shah of Sarasin-Alpen: "We can use examples of equity research, where both models co-exist currently – one where revenue is generated from execution of transactions based on the recommended ideas and another model where lump-sum amount is paid by the users of research. Both models would have their own dynamics. From a user perspective, the former model considers cost as variable one, whereas later one considers the same as fixed cost."

However, there are skeptics here also. Some senior people in the industry privately question the value of ratings. They don't have a high opinion of the ratings, nor of the business model adopted by the rating houses.

Apart from the methodology, the issue is the lack of responsibility. Their view is that rating houses issue the ratings on a particular date, but then shun responsibility the next day, citing market volatility and changed circumstances. So the retail investors are left to fend for themselves.

The issue of conflict of interest is also raised by both asset and wealth management practitioners. Pant is a user of external research. Yet he is cautious about the business models. "Most research houses tend to rely on AMC-engaged research which does bring into question conflicts of interest."

> While AMCs cannot advertise ratings in their marketing, third-party portals may use ratings to help investors sift through the confusing universe of funds.

While some people market players agree that the rating houses do put their brand at stake, and hence are unlikely to compromise their integrity, others believe that ratings should not be a commercial proposition.

However, finding alternative solutions is a challenge.

FUTURE OF RATING HOUSES

In a market where the penetration of capital market products is only likely to increase, market practitioners seem positive about the prospects for rating houses.

Explains Vidyadharan: "For the industry to grow, it is important for investors to have access to independent research and also allied services before investing."

While some industry practitioners are skeptical about the utility of ratings and conflicts of interest, they concede that rating houses have a role to play. Shah is optimistic about their future: "Research houses like any other business proposition pass through a similar evolution phase. Acceptability of research output, effectiveness of recommendations, cost effectiveness of the research process, scalability and repetitiveness of the process are a few aspects which will determine how far research house would be influential. "

Pant is also positive, adding that they have other benefits.

"International research set-ups can bring a lot to the table in terms of new product ideation, international best practices on fund selection and positioning, distribution practices, and investor education." Adds A Balasubramiam of Birla AMC: "The investors not only go by the ratings but also the reputation, the longevity of the fund house and the reliability.... But large pools of people go by the ratings by the rating houses, hence they cannot be completely ignored."

Indeed, SEBI's directive for AMCs to launch direct plans for investors who approach the AMCs directly may lead to a renewed interest in ratings. While AMCs cannot advertise ratings in their marketing, third-party portals may use ratings to help investors sift through the confusing universe of funds. ■

Co-published with Religare Macquarie and Innovaid Advisory Services

GUIDING HNIs ON PHILANTHROPY

Since, 1991 India has emerged as an economic power and as a result, many have experienced a dramatic increase in wealth. Research shows a subsequent realisation that with the acquisition of wealth comes an increased personal social responsibility toward people less fortunate.

According to Forbes, India is the fourth country in the world based on the number of its billionaires. At the same time, India's Ranking in the World Giving Index moved from 134th place to the 91st place based on the country's charitable giving. Additionally, the 2012 Bain India Philanthropy Report highlights that India's wealthy "contributed more of their income in 2011 and many of them plan to give even more in the future".

Of particular note is the fact that "77% of Indian philanthropists are novices, with less than three years' experience". This constitutes a large number of philanthropists who require guidance in navigating the complexity of the philanthropic ecosystem in India.

In response to this, there is a need to provide a more unique, personalised philanthropy advisory service to HNIs in India, which allows them to design

> "There is a need to provide a more unique, personalised philanthropy advisory service to HNIs in India."

their philanthropic legacy in alignment with their personal social interest areas and in the broader context of their overall estate planning.

Budding philanthropists have a very definite vision about what they want to do with their philanthropy, but often don't know how to navigate this specialty area. In order to be effective, best-practice philanthropy mandates a strategic, planned approach to tackling social issues. This in itself is a specialised field and first-time philanthropists need support from experts to be effective in this area.

Traditionally only been offered a predetermined list of NGOs to support, without taking into account their own areas of interest and passion. In actuality, there are five key areas where philanthropists require support:

- **Foundation establishment** – the end-to-end service for the set up, strategy and management of a philanthropist's very own Foundation
- **Grant-making** – development of a meaningful, personalised portfolio of screened NGOs and programmes to support, in alignment with the values and vision of the philanthropist
- **Family philanthropy** – assistance for Indian families in finding inter-generational common ground to strengthen and transfer their philanthropic legacy, with a focus on succession planning to prepare the next generation for an effective stewardship whilst preserving the Founder's established intents
- **Monitoring & evaluation** - to ensure the validity and effectiveness of all philanthropic programmes, there is a need to establish a sound process of monitoring & evaluation to measure and track impact, transparency and accountability
- **Trustee training** – improving a Foundation's effectiveness by strengthening its board and staff performance

Rohit Bhuta and Emily Harrison

Religare Macquarie Wealth Management and Innovaid Advisory Services

When it comes to philanthropy, HNIs have unique needs, requiring a professional service that matches the professionalism they experience in the management of their businesses and other affairs. HNIs have typically built large enterprises across multiple industries and take a strategic approach to operating and managing their businesses across diverse geographies. Philanthropy is no different.

In response to the evolution of philanthropy in India, Religare Macquarie Private Wealth has partnered with international philanthropy consultants Innovaid Advisory Services to provide unique, personalised philanthropy advisory services to HNIs in India.

The first-of-its-kind in India, the service allows HNI clients to design their philanthropic legacy in alignment with their personal social interest areas and in the broader context of their overall estate planning.

** To learn more about this service, please get in touch with an RMPW Wealth Advisor or SMS ACTIVE to 58888. Alternatively you can mail us at active@religaremacquarie.com or call us on our Toll Free number 1800 102 6898.*

Hubbis Forums in 2013

Our Wealth Management Forums provide in-depth, practical insights from experienced, senior industry practitioners from the domestic and international markets on the key issues, opportunities and challenges relating to clients, processes, products, strategy and platforms. For events in local markets, content is tailored to relevant domestic issues and trends.

Compliance in Asian Wealth Management Forum 2013
Thursday 17th January
Pan Pacific Singapore

Asian Wealth Management Forum 2013 – Hong Kong
Tuesday 26th February
Conrad, Hong Kong

The Independent Wealth Management Forum 2013
Thursday 14th March
The Marina Bay Sands, Singapore

Indian Wealth Management Forum 2013
Tuesday 19th March
Taj Lands End, Mumbai

Taiwan Wealth Management Forum 2013
Tuesday 26th March
Westin Hotel, Taipei

Investing in Asia Forum 2013
Wednesday 10th April
Park Hyatt Zurich

Thailand Wealth Management Forum 2013
Thursday 16th May
Grand Hyatt Erawan, Bangkok

Indian Private Banking Forum 2013
Thursday 13th June
Taj Lands End, Mumbai

Technology & Systems Solutions Forum 2013 – Singapore
Thursday 20th June
Marina Mandarin, Singapore

Malaysian Wealth Management Forum 2013
Thursday 27th June
Grand Millennium, Kuala Lumpur

China Wealth Management Forum 2013 – Beijing
Thursday 29th August
Westin Hotel, Beijing

Asian Wealth Management Forum 2013 – Singapore
Thursday 26th September
Marina Mandarin, Singapore

Indonesian Wealth Management Forum 2013
Thursday 24th October
Four Seasons Hotel, Jakarta

Wealth Planning Forum 2013
Thursday 7th November
Marina Mandarin, Singapore

Technology & Systems Solutions Forum 2013 – Hong Kong
Thursday 14th November
Four Seasons Hotel, Hong Kong

China Wealth Management Forum 2013 – Shanghai
Thursday 28th November
Grand Hyatt, Shanghai

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