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HONG KONG

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Editor's Note

Asia to provide opportunities for at least another decade, but alternative strategies are essential

Since the 1997 Asian crisis, most economies in Asia have been pretty stable in terms of the GDP volatility. That includes corporate profits and corporate earnings which in Asia have been reliable as well. Still, Asian equities markets have been a lot more volatile than developed markets, not properly reflected the fundamental facts. The primary reason is that Asian markets are a lot more prone to foreign fund flows that often don't accurately reflect the real fundamentals of the economies or corporate profits. That means on a medium-term basis there are a lot of opportunities to identify undervalued companies with stable earnings and good visibility on the top line.

Where Asia's volatility is coming from and how to deal with it

Whenever there is an equity cycle that is caused by foreign fund flows, astute investors often have tremendous opportunities to buy cheap and to generate a very good return from fundamental stock-picking. A good example is the 2008 global financial crisis which really had its epicentre in the U.S. where the S&P in that year was down 30% while Asia MSCI ex-Japan Index was down close to 60%, mostly due to foreign capital outflow. But throughout that crisis, Asian corporate profits displayed a much lower volatility and Asian markets also rebounded much faster than the Western World. Still, the equity market volatility was a multiple bigger in Asia than the Western World where the problem was created.

The Asian region suffers from a lack of long term institutional money in this region of the world. That exacerbates the volatility and the effects of foreign fund flows. Asian Central Banks' reserves are large, but unfortunately very little of that money is in the equity markets. The Asian pension industry is underdeveloped with very little invested assets. Asian managers see the current markets as a multi-year opportunity which in fact could last for at least another decade; if not, longer.

A lot of alternative strategies that are applied globally, specifically in the U.S. and Europe don't work so well in Asia. That is the reason a large number of Asia-based managers chose to focus on long-biased stock-picking. A lot of strategies that work globally cannot be executed in Asia because of the lack of instruments and the lack of capital structure that you see amongst listed corporates in the region. CTAs and macro work in Asia but a lot of other strategies like mortgage backed arbitrage or simply merger arbitrage will not. Given the information inefficiencies of the Asian markets, stock-picking is seen as the best low hanging fruit, and the managers' long term results prove that.

Why the alternative strategy is essential in Asia

It's important for Asia-focused managers to have the flexibility to be able to take down their net exposure, whether through raising cash or shorting with futures or single stocks. That is why the alternative strategy is essential in Asia. However, most retail investors do not have access to alternative investment strategies. The inability for the Asian mutual fund industry's retail long-only products to take down the exposure below 90% is a huge disadvantage in Asia.

The Opalesque 2014 Hong Kong Roundtable, sponsored by Eurex, Maples Fiduciary and Eurex, took place in November 2014 at the Hong Kong office of Maples with:

1. Edward Hardman, Eurex
2. Robert Welzel, WTS
3. Hugh Thompson, Maples Fiduciary
4. Raymond Wong, Cheetah Investment Management
5. Nitin Dialdas, Mandarin Capital
6. Barry Lau, Adamas Capital

The group also discussed:

- Why Asian managers launch Spanish and U.K. real estate funds
- How Asian managers and investors have matured and "institutionalised" - changes in corporate governance
- How to generate yields of around 18% through providing credit to Chinese SMEs
- Litigation: How to be successful in the Courts of Law in China
- Private REITs in Japan: How to get over 6% net operating unlevered income yield in Japanese real estate
- Domestic Japanese investors are now planning for an inflationary world and move into risk assets - consequences for the stock markets?
- How do Asian managers deal with AIFMD? What do they think about UCITS and European platform providers?
- What products will be offered on Eurex Asia in Singapore?

Enjoy!

Matthias Knab
Knab@Opalesque.com

Participant Profiles



(LEFT TO RIGHT)

Matthias Knab, Hugh Thompson, Edward Hardman, Robert Welzel, n.n.
Raymond Wong, Barry Lau, Nitin Dialdas.

Introduction

Robert Welzel
WTS

My name is Robert Welzel. I am a partner with WTS. WTS is primarily a law and tax consultancy. WTS was founded in 2000 by six partners and we have grown to currently 450 colleagues in Germany. We expanded into East Asia, too, and recently set up offices in Shanghai and Hong Kong.

I am trained as a lawyer and tax adviser and focus on the tax and regulatory issues of the asset management industry, including hedge funds. At the moment, we see more-and-more interest of especially German but also European institutional investors investing in East Asia, especially East Asian hedge funds.

On the other side, more and more funds in Asia are interested in attracting additional European investors. The changes and developments in European regulations are an additional burden for many asset managers, however, they also provide interesting business opportunities worthwhile to be evaluated in more detail.

Edward Hardman
Eurex

My name is Edward Hardman, I represent Eurex, the International futures and options exchange. I joined the exchange about six months ago, working in the Asian business development team.

Before joining Eurex, I was involved in proprietary trading, trading futures mainly in Asia. I started my career as a broker initially on the futures trading floor in London before moving to Singapore to work on the futures trading floor 16 years ago, so I have been in the futures industry for just over 20 years. My responsibilities at Eurex are training and education for traders new to Eurex products in Asia, and I also work with the sales team, mainly concentrating on buy side sales, introducing our products also working with the buy side to find new products.

Barry Lau
Adamas Asset Management Limited

My name is Barry Lau. I am the managing partner at Adamas Asset Management (Hong Kong) Limited ("Adamas"). Adamas is a credit specialist focusing on providing growth capital by way of debt financing to SMEs in Greater China. My partner, Paul Heffner, and I co-founded the firm in 2009. We are currently managing USD610mm.

Nitin Dialdas
Mandarin Capital Ltd.

My name is Nitin Dialdas, together with three other partners I am a co-founder of Mandarin Capital Ltd. The company was incorporated in late 2012 and granted a SFC Type-9 asset management license in 2014. The first two funds to be launched will be in the real estate space investing in Spain, predominately Madrid and Barcelona, and in the U.K. commercial property market. In Vietnam we are in the process of creating an equity fund and a number of redevelopment projects. Staying in Asia, we have a Japanese property Fund which is currently engaged in the process of raising capital.

On a personal level my career has spanned over 18 years working for ING and Richmond Asset Management where I had been engaged in portfolio management for private clients as well as managing a U.S. equity and ETF fund.

Raymond Wong
Cheetah Investment Management

My name is Raymond Wong. I am the founder and managing director of Cheetah Investment Management. I founded Cheetah about 13 years ago.

One of our core activities is finding local talent from around Asia and providing capital for them. We then help them launch funds and raise capital. Our funds are mostly Asian equity strategies with a value style, fundamental-driven and long-biased absolute return. I have been personally investing in hedge funds globally since about twenty years ago, allocating to all kinds of strategies. But in Asia, we focus mostly on long-biased equity.

Cheetah was started as a fund of fund, and we still manage a small fund of funds as well as some discretionary accounts for family offices. But, as I said, our main activity is to identify and help our single strategy partners to grow their business.

Hugh Thompson
the Maples group

I am Hugh Thompson, Global Head of Maples Fiduciary, a division of the Maples group, which also consists of international law firm, Maples and Calder, and Maples Fund Services, our fund administration arm. Maples Fiduciary's core services are the provision of independent directors, managing members, general partners and trustee services to investment funds and structured finance vehicles. Collectively, we have offices in 13 locations and key jurisdictions.

Both Maples Fiduciary and Maples Fund Services opened an office in Singapore in 2013 and I relocated from the Cayman Islands to spearhead the development of Maples Fiduciary, which includes company formation, registered office, company secretarial and directorship services for Singapore domiciled entities. Our office also provides director services with a focus on investment funds to Cayman, Hong Kong and British Virgin Islands domiciled entities where an Asian time zone presence is needed.

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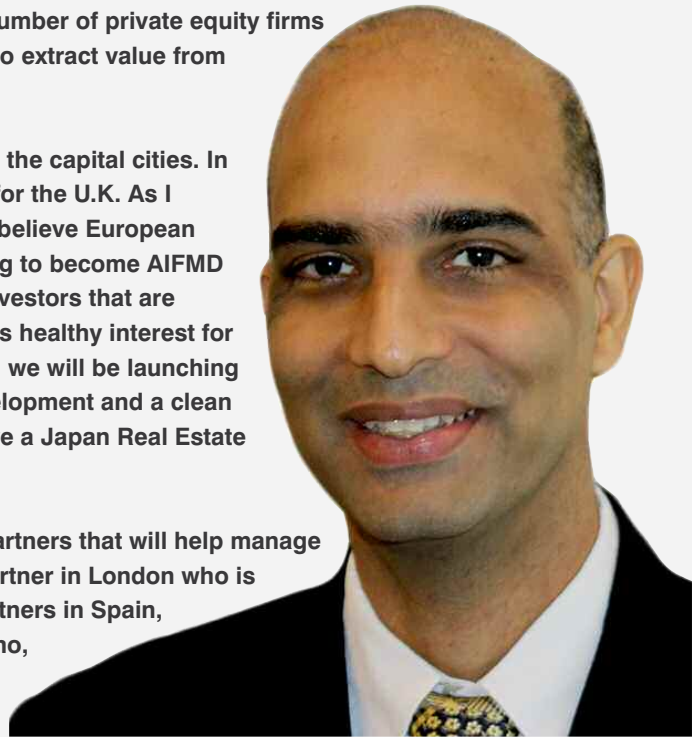
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Matthias Knab Please share with us some more details about the funds you are running, and how your strategies are doing.

Nitin Dialdas: **Like I said, we are a start-up and are actually launching our first two funds this week. The first one is a Spanish real estate fund for which we see quite a lot of interest. We are also working on a U.K. commercial real estate fund as well. We are not looking at residential because we think that's a bit toppy, but the commercial side is about four years behind which makes it an interesting play for us. What we as a firm actually look at is identifying areas globally where we think we can offer attractive returns to clients in areas they are not necessarily looking at and in which there are few competitors. That of course also includes the Asian market.**

Real estate to the Asians is a very prominent asset class. They like it, they understand it. Out of those considerations we decided to focus our first funds in the real estate sector. Spain is a really exciting market for investors. A lot of people look at it as a turnaround story. A number of private equity firms have entered the market in the last nine months as they look to extract value from there.



In all markets where we are active we focus predominantly on the capital cities. In the case of Spain, this is Barcelona and Madrid, and London for the U.K. As I mentioned, we are looking to do Asian strategies as well. We believe European investors will particularly benefit from those, so we are looking to become AIFMD compliant, and that will allow us then to speak to European investors that are looking to increase their exposure to Asian strategies. There is healthy interest for Vietnam that we will be addressing with a Vietnam equity fund we will be launching at the end of the year. We are also working on Vietnam redevelopment and a clean energy project we'll be doing in the Philippines, whilst we have a Japan Real Estate fund on the shelf.

One of the key factors for us is finding good on-the-ground partners that will help manage the funds locally. We have got a very strong on-the-ground partner in London who is employed by the firm. We also have strong on-the-ground partners in Spain, U.S., Japan, Vietnam and the Philippines for those projects who, whilst not employed by us, have very strong ties to the firm.

Raymond Wong: **As I explained before, we have a few equity strategies. We seeded a small cap fund in Japan 10 years ago, a Korea fund 10 years ago and an Asia ex-Japan fund 8 years ago, so a number of our strategies have a rather long track record and have been compounding at very good rates.**

Although the environment for our strategies wasn't favorable this year we still see plenty of stock-picking opportunities in Asia.

A lot of alternative strategies that are applied globally, specifically in the U.S. and Europe don't work so well in Asia. That is the reason we chose to focus on long-biased stock-picking in Asia. A lot of strategies that work globally cannot be executed in Asia because of the lack of instruments and the lack of capital structure that you see amongst listed corporates in the region. CTAs and macro work in Asia but a lot of other strategies like mortgage backed arbitrage or simply merger arbitrage will not. Given the information inefficiencies of the Asian markets we still think the best low-hanging fruit is stock-picking. Our results for the past ten years have convinced us of this.

Since the 1997 Asian crisis, which was 17 years ago now, most economies in Asia are pretty stable in terms of the GDP volatility. That includes corporate profits and corporate earnings which in Asia have been stable and reliable. Still, Asian equities markets have been a lot more volatile than developed markets, not properly reflecting the fundamental depth well. The primary reason is that Asian markets are a lot more prone to foreign fund flows that often don't accurately reflect the real fundamentals of the economies or corporate profits. That means on a medium-term basis there are a lot of opportunities to identify undervalued companies with stable earnings and good visibility on the top line. Whenever there is an equity cycle that is caused by foreign fund flows, you often have tremendous opportunities to buy cheap and to generate a very good return from fundamental stock-picking.



A good example is the 2008 global financial crisis which really had its epicenter in the U.S. where sub-prime mortgages and the whole shadow banking industry created a serious dislocation and problems for mainly the U.S. and then the broader global economy.

So that problem was sourced from the U.S. where the S&P in that year was down 30% while Asia MSCI ex-Japan Index was down close to 60%, mostly due to foreign capital outflow. Asian corporate profits displayed a much lower volatility and Asian markets also rebounded much faster than the Western World. Still, the equity market volatility was a multiple bigger in Asia than the Western World where the problem was created.

The Asian region suffers from a lack of long term institutional money in this region of the world. That exacerbates the volatility and the effects of foreign fund flows. We do have gigantic amounts of money within the Asian Central Banks as Central Bank Reserves, but unfortunately very little of that money is in the equity markets. The Asian pension industry is underdeveloped with very little invested assets.

We therefore see the current markets as a multi-year opportunity which in fact could last for at least another decade; if not, longer. And again, the best way to play that in our mind and in our practice is through a fundamental equity stock-picking strategy in Asia.

Matthias Knab As an asset manager, how do you deal with the high levels of volatility in Asia? How do you deal with the drawdowns?

Raymond Wong: **It's important to have the flexibility in your strategy to be able to take down your net exposure, whether through raising cash or shorting with futures or single stocks. That is why we do believe that the alternative strategy is essential in Asia. We do have of course a long-only Asian mutual fund industry that caters to retail. The inability for the retail long-only products to take down the exposure below 90% is a huge disadvantage in Asia.**

An alternative strategy that allows you to cut your exposure down to 30% or maybe even lower or to market neutral when there is a huge dislocation in the market, that alone could help protect the capital on the downside. And more importantly, through a long-biased strategy like we are doing, you will also be able to catch any rebound by quickly and aggressively switching back to long-biased, when the circumstances are right.



Of course, that has some degree to do with – I wouldn't say timing the market, as in market timing – but the ability to take up the exposure when things stabilize. That has been our experience in 2008 and even in 2011. Our funds did suffer a certain drawdown, but they were also very quick at picking up performance again when things normalized.

Barry Lau: Also from our perspective, the opportunity set in Asia is varied and exciting. In navigating Asia, in our business, in our opinion, one has to be selective, seasoned, local and well networked.

By way of background, we commenced our business with a focus on SMEs in Asia (from Australasia to India) by providing expansion capital across the entire capital structure. The experience was good, however, whilst the work was fascinating, the traveling was grueling and the monitoring of investments across time zones, geography and cultures made it sub-optimal for a manager of our size. We felt we would serve our investors best by being focused.

Five years on our business has gravitated towards funding at, or close to, the top of the capital structure and within the Greater China region. There are a couple of reasons for this.

First, within China, and that includes Hong Kong to a large extent, most of the SMEs in this part of the world are not getting any senior debt offered to them by the traditional means, i.e. bank financing. As a cluster of borrowers, we are looking at around 50 million SMEs in total but only 4% of them are beneficiaries of bank debt. Yet, they contribute to 65% of China's GDP and created 80% of all employment within China and supply in excess of 50% of all tax income to the central government. The dichotomy here is reverberantly pronounced – you have a very significant economic producer who is not getting any support and encouragement by the banks and the government. In order to scale and expand in a Darwinian society – yes, China's SME market is a microcosm of the free-wheeling capitalist market we see in the western world; with GDP growing still at a healthy multiple to the western world – the survivors will be those who can continue to expand with the economy by conquering market share. This is a succinct theorem known to all business operators in China.



We identified the growing SMEs as an interesting sector because:

1) the good entrepreneurs are hungry and want to grow their business; and
2) you can generate yields of around 18% (equity like return) yet sitting at the top of the capital structure.

While this may sound expensive, this brings me to a more critical point - when a company is showing good growth, the entrepreneur, the larger shareholder would typically shy away from selling the equity or diluting the equity participation; certainly we would much rather to see an entrepreneur being reluctant to sell his equity than to openly be willing to offer the equity the entrepreneur has built up over time. For those people, we represent a different solution altogether, because we are not going in there to negotiating say a 30%, 40% or controlled stake in a growing company.

But, we do have our criteria, obviously there are lots of companies out there that we may not want to finance, albeit that we think is an interesting opportunity, because the company cannot demonstrate that stable, steady earnings growth that we like to witness and monitor.

So for those companies that can show good cash flows and growth potentials, we would like a conversation. And more importantly, what we found is that we are now able to get to the top of the capital structure because banks are just not financing. We are even able to get hard assets as collateral in addition to all those share pledges across the corporate structure in exchange for a good cash coupon in the region of 18% p.a.

Now, clearly, can companies be paying this type of return for a prolonged period of time? The answer is no. We are not really interested in financing for a prolonged period of time, but for a year or two years' bridge, the companies we are looking at can absolutely afford to pay this type of a coupon. While typically we want all in at 20% per annum, we may accept a lower cash coupon and negotiate some profit sharing, participation at the back-end and/or free warrants. We have many levers to pull in that process. However, the cash yield has to be in excess of 12% as a pre-requisite.

A question we frequently get is how long will this opportunity set last? What if the central government says, "okay, let's open up the floodgates and finance, fund and feed the growth of our SMEs..." However, we don't see this happening anytime soon. We believe, like Raymond as well, that we are looking at a decade long opportunity, whether it's from a fundamental equity or debt perspective.

Hugh Thompson: Our decision to open Maples Fiduciary in Asia last year was driven by the volume of new fund activity throughout the region, due to increasing investor appetite for Asian exposure and the greater institutionalization of both the investors and the managers themselves. We took this as a sign of the growing maturity of the Asian funds market, which in turn creates an environment where our services are required.

There has also been a twin squeeze on managers from hedge fund investors and tax advisors whereby they not only now need to hire independent fund directors to satisfy market governance standards on hedge funds but also to ensure that structures are sufficiently robust to satisfy tax requirements. This is a newer concept in the private equity world where the global focus on taxation, combined with local rules, is resulting in very conservative tax advice around fund structuring.



Much of this activity is centered in Hong Kong, due to its close links to China as well as the developing China funds market. The greater role for firms such as Maples Fiduciary has meant that there must be more interaction with managers, and offering Asian time zone directors has proved attractive. The follow up to this has been the increase in volume of Chinese funds, who now require independent directors for the first time. This has prompted us to hire a Mandarin and Cantonese speaker with ten years experience in China as a director. The identified need has been for the translation of documents, rather than an inability to hold board meetings without a translator, so having a native speaker improves communication generally and also saves the cost and time of translations.

Matthias Knab Barry, I am sure people also ask you to explain them more about the risks and the safeguards you employ in your strategy of providing credit to Chinese SMEs?

Barry Lau: **Well, we don't even have to get as far as SMEs because lately when you just say "China", people shut their ears. My partner and I have been doing a couple of fundraising visits to Europe and to the U.S., we found that many investors have been indoctrinated by the picture that some of the Western media are painting how China is this frightening and scary place, with lots of ghost cities (1) and with shadow bankers going around and people fleeing the country.**

But when you have boots on the ground there - we have 20 people on the ground in Shanghai, and another 20 people here in Hong Kong, we are very comfortable in executing this strategy. We like taking this risk, because we are able to understand the risks and mitigate them.

To answer your question, Matthias, we focus on two streams of protection. Generally, we don't want to invest in anywhere or anything that we believe does not have a strong and robust legal foundation. While we could have a big debate about whether China offers you that in terms of legal structure, legal infrastructure and legal protection, contrary to popular belief, our experience in China speaks in favor of the regime.

Across our financing platform, we have invested into 55 SMEs in China, and we have had only 5 defaults, which we have pursued them in the Courts of Law in China, and we have won all of them and were able to fully recover our loans. So irrespective of what other observers may have seen in China, in the context within the confines of our experience, we found the process to be fairly smooth and unbiased.

But of course, litigation is never easy. So even if we got our money back, it doesn't mean that it was easy. It can be bumpy along the way and time consuming. I would say this would be true even if one litigates in a country operating under either civil codes or common law; in all circumstances anywhere in the world, litigation is good for the litigators. Litigation is part of the business and it's definitely a contact sport; we have to be mentally prepared for it and embrace this facet of our work.



China has progressed to a point whereby they recognize the function and importance of foreign participation. They recognize that the rule of law is important and this echoes what the recent government has said about enforcing the rule of law for China. So these are my comments about the legal side regarding the protection of our business.

On the operating side, we implement a whole raft of protection mechanisms, including, but not limited, joint control of all bank accounts, adding our own directors onto the boards of the companies; we also keep the chop of the company in escrow. In China, the perfection of any contract is dependent and subject to the installation of the company chop rather than signature by any individual. So we have all those things in place, and not to mention of course that we will take collateral over any immovables and movables, pretty much everything.

Hugh Thompson When you had to enter litigation, to what extent were you actually getting your money back? Was interest included? We speak with a lot of investors who are anxious on the enforceability of contracts in China and their ability to get their money out.

(1) Refer to the Opalesque 2014 Singapore Roundtable for new ("on the ground") insights into the Chinese "ghost cities" phenomenon.

Barry Lau That is a good question! We have been blessed and were made whole, so we received the principal plus interest. We know even in the western context sometimes creditors may receive a haircut.

Hugh Thompson Was that because you are good at the litigation and the process, or do you think such an outcome would be open to any investor and get similar results?

Barry Lau Certainly, we have come across other parties having a little more prolonged process in navigating the system and that the course being chartered appears to be accretive and additive in measures.

Barry Lau: We go into China with our eyes wide open, knowing that such risks do occur. We do our research and assessment extensively, we are on the ground there, and have been battle hardened with the whole litigation process in China. There are many nuances involving a litigation process, and if in fact you have taken the appropriate steps, it will be very difficult for the local court to challenge that.

For example, if your contract has been notarized in advance, there is a third party authority overseeing it, much like having a third party witnessing a deed in a Western law context.



Now, let's consider about relative bargaining powers for a moment. If one chooses to lend to a local giant of a company, obviously one has to be cognizant of their relative local might over one as a foreign lender. When things are rosy, working with the local giant is wonderful as they typically rub shoulders with the upper echelons in industry, commerce and government; when the tough discussions have to take place, the aforementioned privileges may work against one.

The sort of typical deal sizes that we do is typically below US$20 million. The average loan size is around US$15 million. What that means is that we look for an LTV of less than 50%. So those companies are not small by any means, but they are not so big that they may influence the local lords and certainly the rule of law. I am not saying anyone can, by the way.

So from that perspective we tend to shy away from the larger participants in the market, but the companies we focus on all have a good and growing business, a strong and motivated management team that we believe will help us secure our money back.

Matthias Knab You have published a white paper about enforcement in China, rght?

Barry Lau: Yes indeed, we have published a white paper which Opalesque has also kindly published (2). It sets out all the sort of arrangements and mechanisms of enforcing a contract within China, and we shared it from our own perspective and experience. Please take a look when you have time.



(2) download the White Paper "Enforcement in China" here:
http://www.opalesque.com/files/Adamas_Enforcement_in_China_whitepaper_Sep2014.pdf

Robert Welzel This is very interesting as in Europe more funds and asset managers are entering the debt finance and banking area, too. Due to the banking crisis, banks in various countries, such as Spain for example do not provide sufficient debt financing to the non-financial sector anymore.

From a regulatory perspective this is an interesting development that funds are entering this core banking area;the disintermediation of the banking industry continues.

Matthias Knab I think Adamas does have a license to do that kind of business in mainland China, no?

Barry Lau: Without trying to go into too much detail about this, what I would say is in the context of China, what the West has branded as shadow banking industry (sounds a bit sinister) is anything but sinister, all bar a few.



The shadow banking industry comprises, in my opinion, the following: the trust companies, pawn loans companies, small loan companies, credit guarantors, financial leasing companies, and progressively so-called asset managers, much like ourselves. All those are, in one form or another, regulated.

For us, we are regulated here in Hong Kong by the SFC. In China we have a RQFLP (Renminbi Qualified Foreign Limited Partner Program license). You may have come across RQFII, which invests in the secondary market. We have RQFLP, which enables us to allocate capital in the primary market.

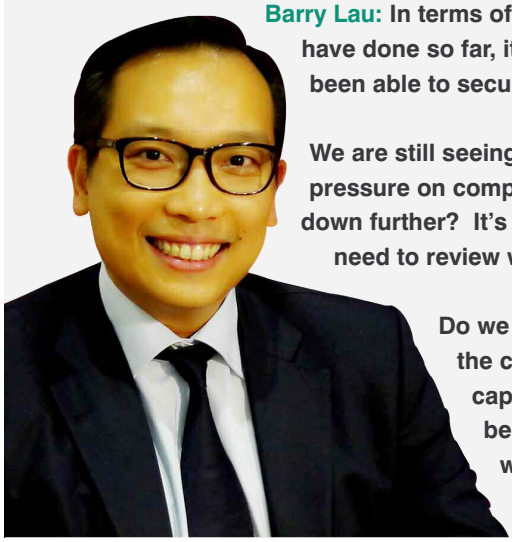
We enter into entrusted loans with local banks who then enter into tripartite agreement with us, such that we are able to take in asset pledges of onshore assets, which in our opinion is a game changer, because historically most foreign lenders have been doing offshore financing, onshore collateral. However, the security here is mostly share pledge. It helps; it mitigates 95% of the risks. It's the 5% that can go wrong. And in our business when you are only clipping coupons, there is really nothing fancy about it, and one bad deal is already very bad. That's why we spend a lot of time trying to understand how we can navigate around this and hence we obtained this license.

Raymond Wong I think what Barry does is very interesting. I am happy to share a few observations on the macro perspective a bit later, but for now let me ask you a few questions.

Raymond Wong: When you do this lending, obviously the coupon is very high. What sort of LTV do you get into? I also assume that you would be the most senior lender, so you have the first claim on the collateral. Would you allow more junior creditors into the structure after you have done the deal?



Also, what sort of deal flow are you doing now? You said you have done over 50 loans. Over what period was that, and on a forward-looking basis, what sort of deal flow are you seeing in terms of number and volume?



Barry Lau: **In terms of LTV, we set our focus on 50% LTV. Actually, if we take a snapshot of what we have done so far, it's bordering around 40% on average. That is about the ratio where we have been able to secure our deals.**

We are still seeing plenty of deals and our pipeline is growing consistently. There is always pressure on compression of yield, however, 18% remains very achievable. And could that come down further? It's a function of the overall market development. In the event it does, we will need to review whether the then prevailing acceptable return justifies the risks.

Do we welcome more junior investors? Yes, we do, because that helps to bolster up the capital structure of the company and enables the firm to have more working capital, amongst other things. This of course is premised on our positioning being at the top of the capital structure, and subject to our approval as to whether junior creditors come in or not.

Raymond Wong So you can influence the terms of how the junior comes in?

Barry Lau: **Absolutely! Let me also make the link here to the banks.**

We love banks, because they will come in on the back of us. We don't see ourselves as a type of loan shark, that is an entirely different type of business. We are under no pretense that we are expensive; however, we also have a broader focus when we work with companies, e.g. the installation of good corporate governance and best practices are some key qualities and attributes we pursue as well. That means the company we finance today, in case you look at the firm again in a year's time, their overall valuation should have improved dramatically more than what we have commanded by way of coupon.

For example, we just exited a transaction recently with a company listed on the GEM Board in Hong Kong. We charged 20% cash coupon in a one year transaction. The interesting thing is that over the course of that year the company's market cap has tripled. So from that perspective, it was a great result for everybody involved.



When it comes to the average term period, we like to be just under one year. The best risk mitigant in credit is to get your money back as fast as possible, irrespective of all the wonderful governance structure we would like to instill in the company. The best thing for me to sleep well at night is to have the money back; everything else would be a great bonus and obviously adds to our credentials.

In terms of the current deal flow, the space we are looking at is still very healthy actually, in terms of the number of companies needing growth capital. China is still growing at a minimum of say 7% (although President Xi remains adamant and upbeat that the target of 7.5% can be achieved), which is still more than a lot of other places by a fair margin. So, from a macro perspective, if a country is growing at that rate, companies need to grow themselves. If they don't grow, they will get taken over and be consolidated by other bigger guys. So, on the company level there is a fight for capital.

The compression of spread is something that we need to monitor, because once it gets down to a certain level, and let's say 15%, it becomes less attractive from a risk-adjusted return perspective. At that point we may have to rethink if China really is the best place for our fund, because if I am able to get 15% elsewhere, for example Hong Kong or Taiwan, and my legal risks would be from a conventional perspective lower, and also from a tax standpoint my leakage is lower. I would then look at those other places.

But currently, at 18-20% there is still an abundance of good and solid companies we are able to identify. You also need to be aware that we apply tough filters, so for every 100 deals we look at it will be only five that we actually conclude with a transaction.

A lot of deals will fall through in the negotiation stage, and that is mostly because of a combination of due diligence together with a combination of egos, I don't know whether it's ours or the entrepreneurs', but what can happen is that if we detect during the negotiation any ego is causing a problem, we would rather exit gracefully, and early...

Raymond Wong Do you have a preference for certain industries or geographies?

Barry Lau: We say we are industry agnostic, but we shy away from IT or new tech. To finance those sectors you require a deeper expertise, and from that perspective we tend to be pretty boring guys. We like the consumption theme, because we adopt the philosophy that consumerism is a great freedom, a freedom that people in China are not necessarily afforded, but through consumerism they are able to express it by making the choices they determine appropriate for themselves. We strongly believe that people want to eat better, sleep better, and live better. Those are the fundamental choices that people have when their standard of living has improved.



For example, we have invested with a resort that provides second homes in Moganshan, which located in a nature reserve outside of Shanghai, so people can have a holiday home there. We have invested and exited within a year with a 25% return.

People are also looking after their health, so we invest in healthcare. For example, we invested in a ginseng farm where we provided financing for the development of so-called traditional Chinese medicine cultivation business.

We need to understand the partner we work with is going to be keen enough to repay us the capital that we lend him for his growth, and then we will be happy. We will part ways. Maybe there will be other opportunities to work together, but in principle we will not loan to own. We want the entrepreneur to fully take back his possessions from us, so long as he meets the pre-agreed lending arrangements.

Raymond Wong That is interesting, because most people's image of lending in China would be through state loans, and to the real estate sector. But while the companies you finance are mostly non-real estate the collateral you take and like is mostly real estate. Is that fair to say?

Barry Lau: Yes, that is a good conclusive comment. We also understand that a lot of our peers are focused on real estate developers. The funding gap just in real estate is immense, developers as a group are not getting much "love" from banks…

As you can see, this space is big enough to accommodate a lot of players, so we welcome more people. But from our idiosyncratic standpoint, we want to stay away from developers for the following reasons. For one, if a developer defaulted, I don't want to deal with an incomplete project. We won't go in there and finish off the building.

In terms of real estate margin, the developers' margins today is a lot lower than what it used to be several years ago. So the question is whether they can pay the rates that we charge? The answer is probably yes, but then I will ask, if I am able to get 20%, why would I wish to be a developer having to do all the work associated with development, including but not limited to dealing with contractors, government agencies, banks, sales and marketing, etc. The margin a developer is getting over a 5 year period is not much more than around 25% p.a. In reality, they are paying away a couple of years margin to secure financing...



The third and final point is that even assuming we have partnered up with a developer and that the development project is completed, the repayment to us will typically happen through the sale of units.

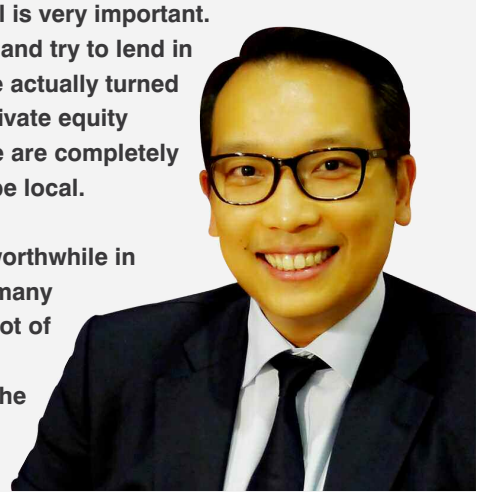
Now, if there is a slowdown in real estate across China in terms of the prices transacted coming off, would that affect the repayment? Most probably. The bifurcation between the rich and the poor, amongst other reasons, has caused the government to maintain its tough stance in keeping a lid on the possible and foreseeable real estate bubble. The consequential impacts are as follows: One, there's going to be delay in sales. Second, there's going to be compression on prices. Due to the above reasons, we prefer non-developer type opportunities.

Nitin Dialdas It is very interesting what you are talking about. What are the actual barriers to entry for other competitors? You said you welcome competitors; the margins are obviously quite attractive, so what are the actual barriers competitors have to be aware of?

Barry Lau: First of all, there are different players involved with informal lending in China anyway. As long as you have got spare capital that you want to lend, you may. Now, what we have seen is a lot of people are lending on the back of an envelope literally. I lend you X, you pay me Y, by when, and the interest rate as Z. There is very little infrastructure in the informal lending space.

We have an onshore license to conduct this business; our procedures are a bit more organized and substantiated.

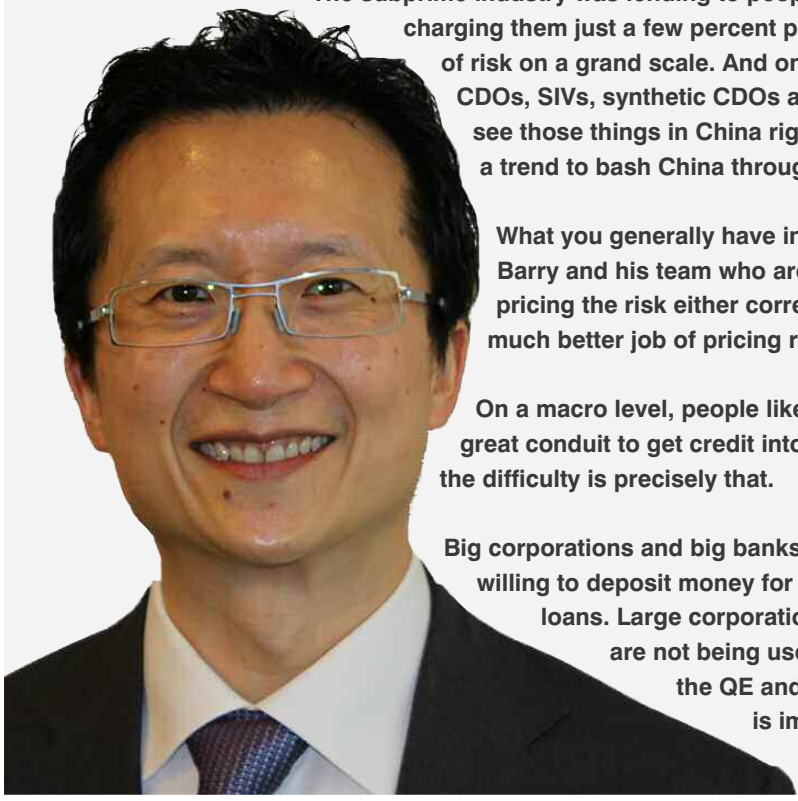
We have 40 people in our firm, close to half are focused on servicing. Being local is very important. This is a very local business and it's very difficult for a foreign lender to come in and try to lend in China. We have seen a lot of private equity firms trying to do that now. They have actually turned their business into lending businesses in Greater China. And because of their private equity skills background, I am sure they will do well; albeit that equity and credit people are completely different species. However, I would still advocate and maintain that you want to be local.



Last, but not least, it took us 18 months to get our license. So that's something worthwhile in thinking about, not necessarily in our particular type of license, there are many, many types, as I also hinted earlier, and different licenses will suit different players. A lot of participants have used so-called small-loan company licenses, those are quite abundant, but you need to really then consult Robert or other lawyers, because the tax can be very complex.

Raymond Wong: One of our funds is an Asia ex-Japan long/short equity, so we have looked at the situation in China closely over the years. Shadow banking became a major worry for foreign investors about three or four years ago when people first started hearing about these wealth management trust products.

We do a lot of work studying this sector of private lending in China, as Barry is doing. Yes, his firm does private lending to presumably more risky businesses, but then he's lending at 50% LTV (loan-to-value) and charging 15% to over 20% interest. You can call this shadow banking or anything else, however in our assessment this is pricing risk correctly. He has senior control over collateral, lends at 50% LTV, which is very conservative, and lends at the right interest rate for the risk taken. The use of the term shadow banking for this strategy is unfortunate in our view because people just conjure up the image of Lehman Brothers or subprime in the U.S.



The subprime industry was lending to people without income, without jobs, at 100% LTV, and charging them just a few percent points for a 30-year loan. That is a gross mispricing of risk on a grand scale. And on top of those subprime loans you had a huge pile of CDOs, SIVs, synthetic CDOs and then you get CDS on that stuff as well. I don't see those things in China right now, nor three or four years ago when it became a trend to bash China through the shadow banking label.

What you generally have instead are very diligent and astute investors like Barry and his team who are looking at the business they are lending to and pricing the risk either correctly or incorrectly. On the whole, they are doing a much better job of pricing risk than we saw from the subprime industry.

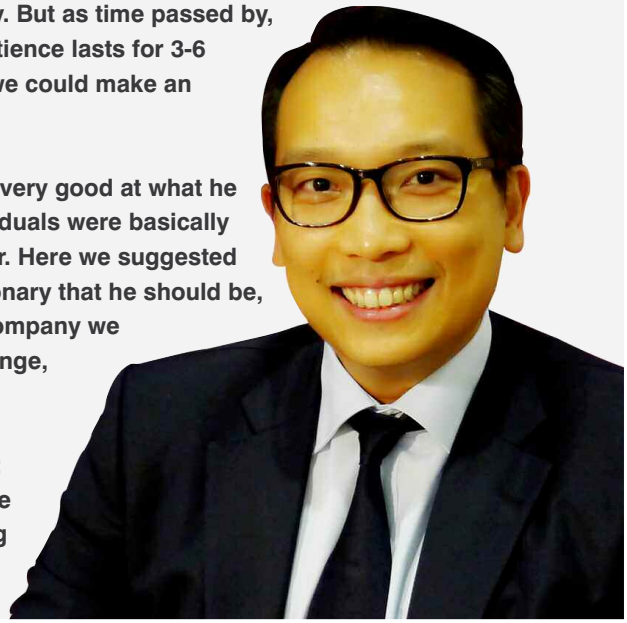
On a macro level, people like Barry and the other private lenders in China are a great conduit to get credit into the economy when right now in the Western world the difficulty is precisely that.

Big corporations and big banks are getting funding very cheaply. Depositors are willing to deposit money for zero interest but the banks are not making any risky loans. Large corporations are hoarding cash. These huge cash balances are not being used or invested. The whole financing cycle, with all the QE and low interest rates, has just created lot of cash that is immobile. At least in China or in Asia, money is moving.

Nitin Dialdas Barry, how much participation do you have in the companies once you give them the loan? Do you just give the loan and say, "pay me back in 12 months", or do you actually have a lot of participation in the management side of the firm?

Barry Lau: We are, how do I put this, I think we are pleasantly intrusive. We sit on the board of the company, we put in place financial controller sitting in locale at the company, we do monitor the development of the company.

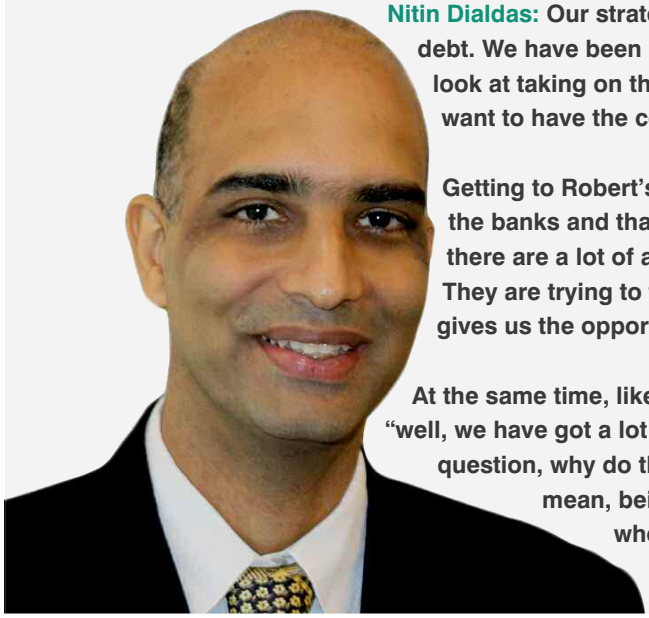
Let me give you an example. We advanced a loan to one company in China that we were told would involve some degree of upgrading of their marketing strategy. But as time passed by, we did not see any result as prescribed. Patience is a virtue, our patience lasts for 3-6 months, So we gently suggested to the entrepreneur that perhaps we could make an introduction of another person to spearhead this initiative.



Another example actually involved the entrepreneur. A serious guy, very good at what he does, but lacking vital people skills to the extent that all other individuals were basically scared to go into work everyday. A great visionary, but bad manager. Here we suggested that since the equity hasn't been diluted anyway that he be the visionary that he should be, and promoted him to chairman. For the daily management of the company we brought in a CEO to help him. We agreed and implemented this change, and it worked out wonderfully as a result.

Sometimes people don't realize that they are a below average boss; they think they are a good boss. Most people don't have the courage to face the reality, but those who do and move on with implementing a better set up will have the better companies.

Matthias Knab Nitin, you are also engaged in an asset-based strategy in Europe, please tell us more about that.



Nitin Dialdas: Our strategy is actually buying physical assets, so it's not taking on the debt. We have been offered by a few partners opportunities where they want us to look at taking on the debt of the assets, but we have declined, because we actually want to have the control of the physical asset.

Getting to Robert's point, the lending is difficult. We are taking a lot of the assets off the banks and that's how we are getting the lending. Especially in Spain, because there are a lot of assets on the banks´ balance sheets that they want to clean up. They are trying to tidy up their balance sheet and us having access to the banks gives us the opportunity to obtain these assets from them.

At the same time, like I have said, we have also got a few partners who may tell you, "well, we have got a lot of the debt that we can pass on to you". You have got to question, why do they want to pass it on to us if it is as attractive as they say? I mean, being in this game for a while, you get a little bit skeptical about when people want to do you nice favors.

So from our point of view, we prefer just looking at the physical asset, being in control of the physical asset, collecting the rent of the physical asset, and then dealing directly with the banks on the debt side. We have been able to do that by getting that asset off the banks and then lending accordingly.

It works well for bank partners. We get assets at prices that we want. The bank gets to clean up their balance sheet. They get a new loan, which reverses a bad debt into what they hope will be a good debt and what we hope will be a good debt obviously. So I think from all parties it works quite well.

As Spain improves and as these assets become less and less, then it becomes interesting, because already we are starting to get some assets that are being offered to us on the private side where the talking to the banks will be interesting. We have got close ties with the banks from the assets we are getting, so we don't think it would be too much initially, but I do think entrants who don't have those kind of ties will face issues in terms of getting lending.

U.K. is actually interesting as well. Even though the market is very vibrant, the lending side is still quite difficult. So on that side we work with partners who have close ties with banks or who are willing to lend. And that, as I have said, is a little bit more interesting.

There are very, very few bank assets now in the U.K., so you are not really going to get those. But if we can get the assets that are attractive to the banks, then they will be willing to lend and they are willing to lend on some decent terms. So that's a little bit more work, working closer with the bank before we get the asset and seeing whether they will lend.

It's a tough environment on the lending side for sure. I think we get a little bit spoilt being in a place like Hong Kong, where everyday, in your post, you get the banks willing to offer you quite a bit of money for very little interest. You are like ¨I don't even know if I can ever pay this back, but thanks for offering it!¨, whereas in Europe, it seems to be a very different case where they just don't want to look at lending.

It has been interesting starting this whole process and working through it over the last year or so. We have learned a lot in terms of what we want to do and where we are going.

Matthias Knab Raymond, you also run a Japanese real estate fund that I think is also very interesting. Maybe you can share it with us more details what you are doing there and what is the investor interest for your fund? From what I know from Japan is that pensions are going to invest much more in such types of funds.

Raymond Wong: Yes, correct, one part of our business is also dedicated to physical real estate assets in Japan. Our team has been in Japan for 15 years and are currently managing about 6,500 apartment units in 14 different cities across Japan, mostly in the form of a Singapore listed REIT.



These are all residential properties. In the Western world this would be called the multi-family assets. Each building would have a number of different apartment units but they are all under a single owner and bought and sold en block as one building. It is a very common asset class in Japan. Most investment properties in Japan are being transacted and invested in this format, as an entire building.

That is very different from the rest of Asia – Hong Kong, Singapore or China – where people buy individual units in a building as a strata owner and then may rent it out. From an investment perspective, in Japan, quite surprisingly, the yields on these properties are still relatively high whereas if you would buy a condo in Hong Kong and then rent it out, you will be lucky if you get 2%. However through multi-family buildings in places even like Tokyo you are easily getting 4-5%; and in regional cities like Fukuoka and Sapporo above 6% in terms of net operating unlevered income yield. Also keep in mind that we get a very low funding rate in Japan. We are able to secure loans in the region of 1.5% for a 10-year credit. So that allows for a very attractive cash flow.

Japan obviously has come through a difficult 20 years which people refer to as two lost decades. Indeed, the stock market peaked in the late '80s but the real estate market in Japan peaked in the early '90s, so we are looking at a 20-year period of adjustment or correction.

But if you look at it in more detail, the price curve looks more like a W, forming a double bottom. The first bottom was around 2001-2002 and then the second bottom was the 2008-2010 trough. Compared to the peak, prices could easily be 70% lower. Prices now have hit a really solid rock bottom, double bottom, and coupled with what Abe had been doing from the political, financial and structural side over the past two years, we believe Japanese real estate is a very, very interesting market right now.

The Japanese had 20 years of deflationary conditioning before Abe came on the scene two years ago, so we can forgive them for being skeptical about the chances of reform. But in the past year we have noticed a change in their attitude. Japanese are now beginning to believe that change is possible and are planning for the possibility of sustained inflation. We believe these changes will play out over the next five to seven years.

Matthias Knab From what I understand, pensions are forced by the Japanese government to get out of their massive JGB positions into other assets?

Raymond Wong: Yes, correct! Obviously, in a deflationary environment, holding JGBs makes sense because you are not just getting the coupon, which is 1% or whatever the number is, but also getting the deflation of 1-2% as a real yield, tagging on to your 1%. That means you basically get 2 or 3%.

But as deflation is replaced by inflation, which is really the intention of the QE, individuals as well as pension funds need to plan for an inflationary world. That means they will have to shift their assets from JGB to risk assets which includes real estate REITs and the stock market. GPIF, the Government Pension Investment Fund of Japan, which is the world's 2nd largest pension, is planning to put a lot more money into stocks and REITs. That is a major move.



We are now seeing opportunity in Japanese private REITs. Japan has a large listed REIT sector which now, because of the QE in Japan, is trading at a premium. QE in the U.S. bought treasuries and MBS, so it was basically restricted to buying bonds. But in Japan, the BOJ can buy REITs directly as well as ETFs in the listed equity market. That's very powerful.

Because listed REITs are now trading at a premium, some pension funds don't want to get more involved in the sector. Also, listed REITs take on the volatility characteristics of the equity markets.

But private REITs in Japan are valued twice a year by 3rd party appraisers and therefore reflect the true value of the underlying properties. They are also not subject to stock market volatility making them very attractive to long term investors like pension funds.

Matthias Knab So the demand is pretty substantial now?

Raymond Wong Yes, it is huge.

Nitin Dialdas Is that onshore demand?

Raymond Wong Yes, from onshore investors.

Nitin Dialdas The reason is ask that is we actually have a Japan fund on the shelf, which was the first fund we planned on doing. Unfortunately, because of the time it took us to get our SFC license, we missed the opportunity because it was last year's story as far as what we have found. When we started taking it to our prospects they were no longer interested in Japan. They already moved on from that. As I said, it was their story last year. So we've put it back on the shelf. I mean, we´ve got the structure there so we can always take it off the shelf, but what we have found is a lack of demand currently, and I guess it´s because we are not going to Japan investors, we are going for investors around Asia.

Matthias Knab That would be offshore investors.

Nitin Dialdas Yes, correct. As we have seen throughout the first eight months or nine months of this year, there is a lot fear over Abenomics, that it's really not working, so that has come into play. Therefore off-shore investors have not been that interested in it. Like I said, we have put it on the shelf until the next time Japan comes back into play, then we can just roll it out.

Raymond Wong: I agree with the observation because offshore investors, non-Japan investors, tend to read the headlines from FT, Wall Street Journal and other Western media. The current worry is whether Abe is losing popularity. There were resignations for unrelated reasons in his cabinet and the overall picture painted by the press seems to be that Abe's policy is losing momentum, that popularity is dropping and that he may not be able to push through his 3rd arrow.

So it is true that when we talk to non-Japan investors we find that their interest has dropped quite a bit during the past year. But local domestic investors are now planning for an inflationary world and are moving more money into risk assets. So we can see a substantial difference in what the locals are thinking and doing versus the foreigners.



Nitin Dialdas You have said that the Japanese onshore investors wanted private REITs. Do they want that REIT structure because they want the income out of it, or is it that they are happy to go into the fund structure, get an NAV twice a year, but not necessarily needed in the REIT structure because they are not too bothered about the income side of it?

Raymond Wong Definitely, Japanese pensions have a great yield requirement. Their primary objective is to get yield. Capital appreciation on top of that obviously would be nice but prices have gone nowhere other than down for 20 years so I don't think the investors are looking for major upward price trends yet.

Matthias Knab Ed, you are more on the liquid side of things. Can you please give us an update about what you see happening from your side in the liquid space?



Edward Hardman: We as an exchange are of course very much into the listed side of the market, and what we see there is the continued futurization of OTC products, being driven by the increased regulation from Dodd-Frank and EMIR. I think we are only going to see more of that.

Some of the products that we have listed more recently have been traditionally traded OTC, for example Euro swap futures, Eurostoxx 50 Variance futures and FX futures and options. As a CCP we are now also clearing interest rate swaps, and we have just launched Euro secured funding futures (repo futures) as well.

I believe that this trend is going to continue, it's something that I have been hearing and reading a lot about over the last few months. I recently read a study by TABB Group that came out just a few weeks ago, and to summarize it said that buy-side managers are expecting to use more listed products going forward than they currently are doing. I think the report actually said that it was much as 70% of funds managers expect to do more listed products and 30% expected to use exchange traded swap futures as an alternative to OTC swaps. So it's not just my opinion as an exchange representative that more of this is going to happen.

Matthias Knab Could you share with us more in detail, how do you see that playing out in Asia?

Edward Hardman: I have been in Asia for 16 years, and previous to working at Eurex I was trading futures myself in Asia. I think regulation here used to be a little bit lighter for managers than it is in say Europe and America, but regulation is starting to increase in Asia as well. I know that many of the Asian based exchanges are moving in to products traditionally traded OTC, to try and benefit from this increase in regulation. There is also plenty of capacity for continuing growth in the region from a derivatives exchange perspective.

Growing our business in Asia is a central part of Deutsche Börse's strategic focus, and one measure is that we are going to launch a new clearing house in Singapore. We have been in discussions with the MAS, the regulator, for a year now to gain approval to open the new CCP.

Initially, the focus will be to extend the trading hours of our core European products, for example European fixed income products and the equity indices such as the DAX and the EURO STOXX 50. In the next phase we will be looking to launch more Asian-based products. So we are looking into extending into products that we can list and that will have an Asian base.



Matthias Knab Asia is a large and diverse continent. Can you specify for us you see the most growth or the best potential for future growth?

Edward Hardman: That's a good question, but from a listed market perspective, the traditional centres of Singapore and Hong Kong are probably where we will see most growth from, simply because they have the highest concentrations of clients and potential clients who use our products. We are also seeing growth from our link with the TAIFEX exchange in Taiwan for whom we provide trading in the TAIEX futures and options in the European trading hours after the domestic market has closed. We have a similar link with the KRX for KOSPI 200 options as well, which has been steadily growing for the last few years.



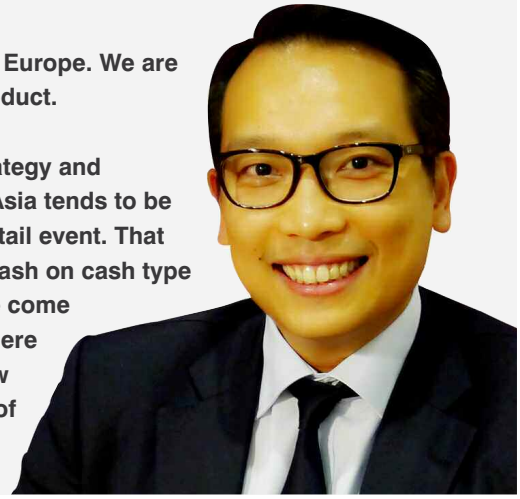
We are seeing growth coming from all over Asia, and we see huge potential for growth coming from China as it continues to open up. We will be ideally placed to serve this growth with our upcoming Asian CCP in Singapore which will enable Eurex products to be traded during Asian hours, with new products to be offered that will have an Asian focus, tailor made for the region's investment needs. We will continue to serve this growing market from our office in Hong Kong from where we also cover India, another market that has huge potential for growth for Eurex.

Matthias Knab We already started to discuss a bit investor behavior and preferences here in Asia. Can you share more details with us about the preferences and trends amongst Asian investors?

Barry Lau: For the moment, most of our investor-base is outside of Asia. On a global basis, there is a reason for this. I believe a global data provider has shown that only 2.5% of all global investors they surveyed have an allocation to credit. So what we are doing with our Greater China strategy is really going against the demand in many ways.

Nevertheless, when we started to build out our credit strategy, we did not think about it from the demand side of things. From our perspective, we believed that this strategy provides the best risk adjusted return, so we decided to pursue it.

The good news is that there aren't many other managers on the supply side who offer this strategy in an institutional format. Competition has just started to grow over the very recent years so that now we may have about 30 such funds, and counting. But in terms of global allocators, going back to the 2.5% number, we believe that that percentage can only grow. If it just goes up to say 5% then we'll be very happy.



Most of our investors have come from the Middle East, the U.S., less so from Europe. We are confident that we will be able to further grow the investor appetite for our product.

Most of our work to date has been in education, apart from executing the strategy and building a good track record over the years. For a typical Western investor, Asia tends to be perceived as a right tail event, and China will represent the very severe right tail event. That means that from their perspective they may be looking to get a 30% or 2.5X cash on cash type return. When we then come in and talk about returns of 1.5X or 20%-25%, we come across as less ambitious. However that is a discussion that we must have where we need to explain the fundamentals of this credit strategy that will then allow us to bridge the gap in terms of expectation of returns as well as the control of the downside risk that we offer.

Nitin Dialdas: From our point of view, being a start up, at that stage it is obviously all about relationships. We are starting off with investors that we have known previously and have had relationships with them. They are the guys who are starting us, the ones that are helping us with getting the funding. We are building relationships with others right around the region. We are in the process of starting to build the relationships around the region, but as I mentioned, the investors that we obviously are getting are the ones that we have existing relationships with. Our European partners have brought some investments in, and we were able to secure investments out of Asia, including Hong Kong, because of us being present over here. But it's not an easy game, trying to get investors to invest.



In Asia, in particular, it becomes very much more about the relationship than the proposition itself. They need to know that they can trust you; and when they trust you, then they'll start looking at the proposition. It's not a case of, "Hey, I like this proposition and then let me see if I can trust you." It's the reverse. It's, "I have to trust you before I even look at your proposition."

That means it's a process, a process that you have to keep building and building and keep working on over time. We plan to be over the long term, so we know that we are starting to invest in a lot of relationships now, which we know will then come to fruition in say, 12 months, 18 months or whenever. At that time we may have also more products on the shelf.

Asia, to me, is a lot harder than say the rest of the world. A lot of the investments we are getting from are actually from Latin America, a little bit from Europe and a little bit from Middle East while a very small part of our initial investment is coming out of Asia at the momnet.

Raymond Wong: The investor base across our different liquid equity funds is roughly one third from Asia, one third U.S. and one third Europe and the Middle East. Hong Kong is home for us and we get great support from family offices. In the U.S. we get investments from institutions, endowments and fund of funds. In Europe and the Middle East we have a mix of investors including insurance companies and sovereign wealth.

Some of these clients have been very long-term clients that invested in different funds as we launched them.

What we saw after 2008 was that the fund flows have become a lot more difficult. Asian investors, especially Hong Kong family offices, are less interested in liquid open-ended hedge fund type investments in the recent years.

2003 to 2006 was a great window of opportunity for providers like us. A lot of wealth in Hong Kong and Asia was created in the real estate sector, and a lot of these investors are very good at what they do with real estate.

But then came the Asian crisis and we saw a real estate bear market from 1997 to the bottom in 2003. This was actually one of the rare periods where people were a little bit disillusioned or skeptical about the sector. But soon after 2003 everybody was focused back on to real estate. We were lucky that we were able to gain quite a bit of traction during the down years of real estate and were then able to keep many of these investors and have them add on to their investments with us.

As Barry alluded to, the risk perception of Asia by foreign investors has changed quite a bit. From the early 2000s to mid-2000 they were a lot more forthcoming in the sense that you would have European and U.S. investors hop on a plane, fly to Asia, look at some really new startup managers, and entrust them with money after one or two meetings. That has of course happened less in recent years, partly because of the changed nature of the industry.



A lot of European fund of funds and Swiss-based private banks have become more risk averse to hedge funds. For that and various other reasons, the new inflows into the industry over the past years have been from the larger pensions and institutions. The issue here is that most Asia-based managers are too small for the ticket sizes. Most Asian institutions invest into large global managers instead of supporting local managers and as a result, most home-grown managers here are smaller and therefore excluded from foreign institutional inflows.

While this is a difficult situation, over the past year or so we have seen inflows from some fund of funds, which we have not seen since 2008. The fund of fund industry itself is under a lot of stress and consolidation but we do see that some very specialized fund of funds have survived and we see inflows from them. That is a bright spot for us.

Robert Welzel: The AIFMD affected the European alternative investment industry significantly. The AIFMD is also relevant to Asian managers who intend to market their funds products to Europe. The one year grandfathering period during which Asian funds could still approach potential clients on a private placement basis just recently elapsed.



This private placement regime is more or less only applicable in U.K. and Switzerland: Germany, which had a very favorable private placement regime in the past abolished these marketing opportunities, too.

What does this mean? First; how will investors still get access to interesting fund managers, and on the other side, how fund managers can approach their potential investors in Europe. There are plenty of pools in Europe, and especially Germany institutional money, which has to be invested to generate additional returns. A significant re-allocation is on the agenda.

If you compare and consolidate Dodd-Frank, FATCA, EMIR and other tax and regulatory developments, I think it's very interesting how the future business models of the fund industry will be impacted. WTS ran a number of comparisons between the U.S. regulations and the AIFMD, and it is very interesting from my perspective to evaluate the upcoming tougher regulations in Asia, too. Probably the burden for managers will rise, but this might even provide for additional marketing opportunities, too.

For example, marketing in Europe: The product placement regime, with exception in the U.K. and Switzerland, is more or less not existing any longer. But if you compare the level of regulation in Asia, the regulatory framework is probably somehow comparable to the European AIFM level. Fund managers evaluating their specific situation might gain access to new, distribution channels and to new distribution routes, especially to professional and semi-professional investors. And 60% of the money in Europe is institutional money, and institutional money only invests in regulated fund managers. So it's quite bifurcated, and the same applies in respect to taxation.

Hugh Thompson: I think the differences between the Japan, Hong Kong and Singapore markets are well understood within Asia, but many in the West have a tendency to group them together under one umbrella – "Asia".

We see the Hong Kong funds market dominated by its proximity to China whereas Singapore has always been the hub for South East Asia and Australia. Increasingly, Singapore sees more business from India as a result of it being seen as more of a substantive jurisdiction, however, the divide between Singapore and Hong Kong remains clear. We are also finding in both locations that the increasing sophistication of market participants means that managers are now much more concerned about a service provider's responsiveness, experience and global network, whereas previously the main concern was over price. Clients have previously experienced how poor quality service providers can have a negative impact on their business, and they are now doing far more due diligence before selecting a provider.



The regulatory tidal wave of FATCA, AIFMD and KYC also means that, increasingly, smaller providers don't have the resources to develop solutions and are looking for exit strategies. These pressures are pointing to a consolidation in our industry where it will be dominated by large multi-jurisdictional groups who have the ability to service global clients with one-stop-shop solutions. We believe that we are one of these firms and our recent investments in the region are a sign of our confidence that business volumes in Asia are going to increase.

Matthias Knab For a number of reasons, platform providers have become quite widespread in many jurisdictions and financial centers in Europe. But even on a platform, you need to have a certain volume to make your business or fund work.

Raymond Wong: Yes, that is right. We looked into complying with AIFMD or even launching UCITS products, and we looked into a few platforms to see how they work, what would be the additional cost and the required minimum AUM if we diverted some of the assets over to seed something like that. We haven't done anything yet, although we have been looking for two years.

It is very "chicken and egg" because we don't want to do something without having a solid feel that there is a demand that would allow us to launch with a certain size, and then after a certain period continue building it up to a desired target size.



But what Robert says is interesting, all these added rules, compliance and regulation actually made things more difficult, even over the past two years when we started looking at platforms, UCITS, etc. More and more rules either come or are being proposed or being implemented in stages. For a firm looking at this from the outside it appears like the goal keeps moving further away all the time when you just aim to reach it.

So European regulations in particular are becoming or are in fact already a structural problem for Asian funds and Asia managers, also because of historic reasons like the lack of institutional money here and reliance on cross border or outside institutional money while at the same time a lot of these barriers are coming up.

For us sitting here in Hong Kong, a lot of those regulatory developments happening in Europe and the U.S. look to us as pure protectionism. Unfortunately, for a younger industry that is in its infancy and tries to grow and is to some extent relying on this outside money, these protectionist barriers actually make it a lot harder for us.

Hugh Thompson: As a law firm and a service provider, a part of our life blood is new fund launches.

We mentioned that Asian funds are smaller, and we don't have the institutional seeders based here, so the vast majority of funds launching are smaller than what would be typical in Europe or the U.S.

Asian funds also suffer from the global regulatory push and the heightened requirements of institutional investors who are now interested in business plans, systems, service providers and infrastructure generally where previously they would mainly be concerned with a fund's investment strategy or its star trader. All of this comes at a cost but it is difficult to attract serious investment until this is in place. There is this imbalance between the cost that the manager has to incur in order to have a product that is sellable, and how you incur that cost and actually have the performance to attract the money. There is a two to three-year gap of struggles to get the fund underway until the manager has that balance of performance and infrastructure.



So many Asian funds get caught in this chicken and egg scenario where they struggle to attract larger institutional investment at the outset due to the difficulties of funding a proper set-up. As a result, these funds lack scale as they are mainly seeded by friends and family. Without scale, these costs are a disproportionate drag on performance at a time when a new manager needs to be building track record. These managers are working towards that point where they can sell to the international investor, the endowment or what have you, but that doesn't come until they can show a track record – and the full-blown infrastructure that these investors need to see.

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