

# Asia growth continues

## ► ASIA OUTLOOK

*Michael Sleightholme* director and region head of custody and clearing, at Citigroup Global Transaction Services, looks at the challenges facing new investors in Asia.



**Michael Sleightholme, director, head of direct custody and clearing, Asia Pacific region, Citigroup Global Transaction Services.**

**C**itigroup Global Transaction Services is a leading provider of integrated cash management, trade, securities and fund services for corporations, financial institutions, intermediaries and governments around the world. With over \$115 billion in average liability balances, more than \$6.4 trillion in assets under custody and the largest proprietary branch network, Citigroup's award-winning operating systems and Internet-based delivery channels enable clients to manage and monitor working capital and investments more efficiently, streamline transaction processing cycles, and re-engineer receivables and payment processes. Citigroup Global Transaction Services provides clients with access to Citigroup's full range of capabilities and solutions, together with an on-the-ground presence and in-depth knowledge of more than 100 local markets.

**Q: In May 2004, Citigroup acquired a majority stake (97.5%) in KorAm Bank in Korea, the sixth largest commercial bank in Korea, with total assets of \$36.8 billion. What benefits can the new Citigroup and KorAm organization offer its clients?**

**A:** Korea has been at the forefront of the economic recovery taking place among Asian countries following the financial crisis that hit the region in 1997 and 1998. Korea is one of the fastest growing markets in the world at present, in which we have seen a huge amount of investor interest across the board in the last six to 12 months, and it is well positioned for future growth.

In particular, improvements in accounting standards and corporate governance, as well as recent changes in Korea's regulatory framework and market infrastructure – such as the introduction of the Indirect Investment Asset Management Business Act in January and implementation of the Korea Securities Depository (KSD) Trust System in April 2004 – have brought stability and transparency to Korea's asset

management industry. These measures are increasing the industry's attractiveness to foreign investors, which continue to invest more of their holdings in Korea. As a result, foreign stock holdings now represent more than 43 percent of overall market capitalization, up from just five percent in 1992.

Citigroup was the first foreign bank to establish a presence in South Korea in 1967, and is the only financial services organization in Korea that can provide a total financial solution for any client across corporate and investment banking, securities brokerage, retail and private banking. Acquiring KorAm Bank will provide a major boost to the services we can offer in this burgeoning market.

In general terms, KorAm is a well-entrenched, top six local bank, which brings a huge local network on both the retail and corporate sides, with a strong customer base in the local corporate space that is bigger than that which we already have. In the securities space, KorAm brings an extensive distribution network, as well as specific advantages such as a trustee licence, which allows us to cross-sell some of the agency and trust capabilities we have developed globally into the Korean market. Therefore, combining Citigroup's strengths – which includes our global network, a full suite of global products, and our credit and funding power – with those of KorAm will allow us to bring a whole new suite of services to Korean customers.

On the trustee side, one of the topics we are discussing with our asset management colleagues is how we can provide more trustee services in the area of money trusts. Again, the combination of Citigroup's expertise, with the international standards we bring to the table, and the distribution network within KorAm puts us in a very good position to do that.

In the longer term, we are looking at areas such as fund administration services. Last year Citigroup purchased Forum Financial Group, which is a big global player in the transfer agency and fund administration space, and we are looking at how we can leverage that capability in the Korean market, using KorAm's on-the-ground presence and the requisite licences it already possesses.

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**Q: Where in Asia have you seen the greatest investor interest?**

**A:** The greatest inflow of investor interest this year is clearly in India and China. There has been a huge amount of inflow into the Indian market, although that has slowed in the run up to and following the fall-out from the recent general election. The market has picked up since though, and we are seeing considerable interest and a lot of new applications from investors looking to get into the market.

However, it is important for any investor going into a market such as India and China to be aware of the regulatory environment. India remains a highly-regulated market, and there is a fairly lengthy application process to go through to become a foreign investor, which typically takes weeks and sometimes even months, rather than days. So it is critical that they have good advice on the ground and that the custodian banks involved have good connectivity into the regulators at a senior level. Such access is something that Citigroup focuses on in all markets, but particularly those that are highly regulated, so we can bring a lot to the table in terms of helping customers navigate through the regulatory environment in India and China.

China is clearly hot. Foreign investment in China's B-share market has been permitted since 1991, but access for foreigners to the huge A-share market was only made possible with the introduction of the Qualified Foreign Institutional Investor (QFII) scheme in November 2002. It then took approximately seven months from when the QFII regulations were announced to when the first trade, which was executed by UBS, was actually settled, by Citigroup. During that time, Citigroup acted as advisor during the drafting of securities related regulations, lobbied the China Securities Depository & Clearing Corporation (CSDCC) to waive the settlement reserve fund to reduce client costs, work closely with the China Securities Regulatory Commission (CSRC) to promulgate the July 4 2003 Notice to enable the first QFII trade, and was the only custodian to be invited to the QFII future development discussion.

That really demonstrated the commitment and connectivity we have in the Asian markets, where we have a strong regulatory interface, the ability to be able to work with clients and regulators alike to get things done, to influence change and to help customers work through the regulations that exist in some of these markets. As a result, in China Citigroup now has a 50 percent market share in terms of the total approved quota under custody and has processed the most QFII transactions in the market, using a highly automated, STP processing environment, with a unique track record of 100 percent of transactions processed on time without errors.

**Q: What significant regulatory developments and challenges can foreign investors expect to find in China?**

**A:** There is still a significant amount of development that needs to take place in the Chinese market, as some of the regulations are still being finalised. A key area of concern is the tax rules for foreign investors, which have still not been clarified, almost a year on from the start of the programme. As a result, it is an area where we are spending a lot of time working with the regulators.

In general, the QFII environment itself has been quite successful. There has been slightly more interest in the country than we expected, but the environment is still quite restrictive, with a number of ongoing issues that act as a barrier for some potential foreign investors to get into the market. For example, there is a lock-up period of at least a year for investors entering the market, as well as a minimum investment quota of \$50 million. We are working with the authorities hopefully to change these practices over time and thereby open the market up to more investors, but for the time being it remains quite a tough market in which to do business.

Another area of interest we are currently looking at is the Qualified Domestic Institutional Investor (QDII) regulations, which will allow domestic Chinese investors to invest overseas. From a custodian perspective, it will open up huge opportunities in areas such as global custody and fund administration. What we expect to happen is for some insurance companies to be allowed to invest overseas first of all, before the broader QDII regulations come out, which will allow the wider domestic investment community to access foreign markets. The regulations are not out yet, and as yet no specific timeline has been set for their introduction, but we hope we can get some movement in this area by the end of the year.

From a custodian point of view, there are also developments occurring in the local mutual fund market. Many international fund managers have already gone into China via joint ventures with local partners, but now the foreign banks are looking at applying to become custodians for local mutual funds. We expect to see some progress in this area before the end of the year, and believe it will be a huge opportunity for us.

**Q: In your opinion, what are the fastest growing opportunity markets and securities products in Asia?**

**A:** The securities markets in Asia have performed very strongly pretty much across the board, particularly in the first quarter of this year, with transaction volumes up significantly. As a result, we have seen a few things happening that are opening up opportunities for us.

An area of particular note is the broker/dealer side of the business, where we are seeing more broker/dealers coming into markets for the first time, or returning to markets they pulled out of in the past. That has coincided with regulatory change in a couple of jurisdictions. One of the most interesting is Australia, where a change to the regulations allows for remote membership directly into the Australian Stock Exchange, which means overseas broker/dealers that do not have a presence in Australia will be able to become members and trade remotely into that market. That seems to have created a lot of interest from overseas broker/dealers, which are coming to us in search of third-party clearing type solutions to support

their prospective businesses in that market.

In a few other markets around the region we are seeing similar demand, although they do not as yet have the remote membership concept. Hong Kong would be one, with Singapore to a lesser extent, as well as Japan. In these markets, we are seeing customers looking to take up exchange memberships, but they are unwilling to set up back offices where they do not already have them. Instead, they are looking to a custodian to provide them with a third-party clearing service.

In time, if a few broker/dealers were to take up the idea of remote membership in Australia, it could eventually have a knock-on effect on the rest of the region. The face of trading and clearing in Europe has completely changed over the last five years as a result of the implementation of the Passport Directive. Asia is a long way behind Europe when it comes to economic and political integration, but, from a securities market perspective, once one or two markets start to change the way they look at membership, and particularly remote membership, there really will be a sea change in the way markets operate in Asia. As a result, we are likely to see more third-party clearing in the region, so there is a real window of opportunity.

We are also seeing opportunities arise on the global custody and fund administration side of our business. In a number of markets, for example Malaysia, India and Taiwan, for the first time they are liberalising regulations that will allow domestic investors to invest overseas, in a similar move to the QDII initiative in China. Such developments provide us with opportunities to sell global custody services to customers in these markets.

For example, earlier this year the Taiwan Public Service Pension Fund appointed Citigroup as its global custodian—the first global custodian appointed by the Taiwan government to manage its foreign investments. In addition, another couple of public sector entities will be outsourcing their funds management and administration later this year.

A similar liberalisation is occurring in Malaysia, where they are now allowing domestic funds to invest offshore for the first time, thereby opening up opportunities for Citigroup in fund administration and global custody. This is exemplified by the recently-announced agreement with Amanah Raya (Labuan) Limited (ARL), the offshore subsidiary of Amanah Raya Berhad (ARB), a wholly-owned government corporation formerly known as the Department of Public Trustee and Official Administrator of Malaysia. The agreement formalised a strategic alliance with Citigroup to offer global custody and securities services in Labuan. Through the partnership, ARL will leverage Citigroup's worldwide presence and state-of-the-art infrastructure to offer global securities and custody services to large, medium-sized and boutique institutions operating in the Labuan International Offshore Financial Centre (IOFC) in Malaysia.

In general, the domestic funds space is increasingly important in the region, and that requires services such as transfer agency and fund administration, for which demand is growing. To date, we have in excess of a 30 percent market share in Thailand and have been successful in Malaysia with the opportunities that have arisen there. We are also having a good look at India at the moment, to see how we can best leverage the dif-

ferent capabilities within Citigroup to provide transfer agency and funds administration services there, perhaps by leveraging the capabilities of the Forum Financial Group, which we acquired last year.

**Q: From your experience in the region, what services are most in demand? Is outsourcing taking off in the same way as in the North American and European markets?**

**A:** Clearing, transfer agency and funds administration are the key areas of focus in the Asia-Pacific markets. While the outsourcing model is more advanced in North America and Europe, there is a lot of discussion taking place in the Asian region as well. Increasingly, there are a lot of funds under administration and a lot of fund managers looking to outsource. On the broker/dealer side, a number of customers are conducting strategic reviews of the region and determining whether it makes sense to run a back office, or if it would be more appropriate to outsource the functions to a third-party provider. So while the opportunities are probably not as prevalent as they are in Europe or North America, it certainly looks like a growth area.

**Q: What are the key business priorities for Citigroup Global Transaction Services (GTS) in Asia?**

**A:** A key objective is the integration of the KorAm business, which is well underway from a corporate perspective. From a GTS standpoint, we are engaged in making that transition already, for example by establishing a product team. We anticipate that the integration will take place at the end of this year.

Another key component is the development of the Chinese domestic market, in particular the progress of the nascent QDII regulations. In addition, third-party clearing in Australia, Hong Kong and Japan are all at the top of our agenda in terms of key deliverables for this year, as is derivatives clearing in India.

On the product extensions front, the key priorities for us are to further develop our transfer agency and fund administration products. We are already in the transfer agency business in Asia – in Singapore and India – and we are looking at how we can take it to the next step by leveraging the capabilities we have in the Forum Financial Group. Lastly, technology investments are a key priority for us. Custody is a scale business that requires us to have the latest infrastructure in place and stay ahead in the field. To this end, we continue to focus on upgrading our technology platforms and improving links with the depositories and exchanges in key countries in Asia.

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A year ago Asia was a tough environment, not least because we were in the middle of the SARS virus and the fallout from that. But the situation is very different now. We are seeing very buoyant markets, allied to some interesting regulatory change that should foster further growth. Market participants are looking to make strategic decisions about the way they manage their business, and as a result we are seeing a lot of new customer interest and significant business opportunities. **E**