Local Insights: Poland

When asset managers are considering growth markets, Poland doesn't always make the shortlist, though perhaps it should. At $771 billion in real GDP in 2011, Poland's economy is the largest in Central Europe, and the 21st in the world.[1] The country's major exports include machinery and manufactured goods, and its major trading partners include Germany and the United Kingdom.

Economic considerations make Poland intriguing, but so does the development of the financial services sector. Barely 20 years old, the local stock exchange boasts a market capitalization of nearly $140 billion as of December 2011. And while Poland's growth so far has been impressive, comparing market capitalization or managed assets to GDP suggests that there could be more to the story.

Growth of Asset Management

Poland's asset management industry is still developing, but already strong compared to its peers in emerging Europe. At $25.4 billion in mutual fund assets under management (AUM), Poland's market is larger than Croatia, The Czech Republic, Hungary and Russia *combined*.[2] "Assets grew significantly from the mid-'90s, at almost a 50% compound annual growth rate until 2007," notes Artur Binkiewicz, Citi Securities Country Manager, Poland, "but then in the crisis, AUM was cut in half."

More recently, the number of funds has tripled, which has been somewhat of a mixed blessing. On the one hand, there has been a proliferation of funds across the risk spectrum, including those that focus on individual regions and sectors, offering investors more choice and a product for many market environments. Closed-end funds have also enjoyed strong growth. On the other hand, as assets have trended sideways in recent years, the growth in number of funds has reduced their average size. "There are a number of big, stable funds," observes Binkiewicz, "but also a lot of new funds that are very small," leading to questions about their sustainability.

In terms of distribution, banks are a major force, both in terms and selling funds, and gathering deposits, which have figured prominently in Poland for historical reasons. Banks typically employ one of three models: closed architecture (selling their affiliated funds exclusively), mixed

[1]World Fact Book, Central Intelligence Agency, November 13, 2012.
[2]The Cerulli Edge—Global Edition, September 2012.

Poland also boasts a strong institutional market, composed largely of pension funds and insurers.

architecture (augmenting their proprietary offering with options from two or three partners to provide a degree of choice) or a completely open fund supermarket. The independent financial advisor (IFA) channel boasts a couple of significant players, but still remains small relative to the banks. Direct-to-consumer sales and family offices are models that do exist, but are fairly nascent to date.

Poland also boasts a strong institutional market, composed largely of pension funds and insurers. "Pension assets are roughly PLN230bil ($80 billion)," Binkiewicz states, "significantly larger than the fund business." Pension funds are invested mostly in government bonds and money markets, and while they have limits on the amount they can invest in equities, they also cannot invest 100% in government securities either. Insurers tend to have very conservative asset allocations.

Globalization

Around 2004-2005, Binkiewicz recalls, foreign firms began distributing in Poland. A couple of well-recognized global brands launched Luxembourg-registered funds distributed in Poland, enjoying some success. "However, if you compare their AUM to that of the local players," he counters, "global players represent maybe 3% of assets."

Yet if globalization is still taking hold on the distribution front, it is well under way in the capital markets. Established in 1991, the Warsaw Stock Exchange is fully dematerialized, with a market capitalization currently higher than that of the Vienna Stock Exchange. "Companies in neighboring countries such as the Ukraine, the Czech Republic and the Baltics often list here," Binkiewicz explains, "since it's possible to raise capital here with liquidity." These companies realize that their home markets are illiquid, and sometimes see listing in Poland, the largest economy in Central Europe, as a way to show their commitment to the market. "If you're a foreign company investing in Poland, doing business here, and wanting to be recognized," he reasons, "you list here to increase your local visibility."

Although access to emerging markets can sometimes be problematic, investors can access Poland quite easily. "The market is quite open," observes Binkiewicz, "there are not really a lot of controls, and access for foreigners is really no different from local investors." There are no significant ownership restrictions for foreigners beyond standard concentration limits that apply to local investors as well. Most foreign investors tend to focus on equities and government bonds; foreign investment in corporate bonds or derivatives is lower. Binkiewicz does caution foreign investors to familiarize themselves with withholding tax procedures. "If certain conditions are fulfilled," he states, "it is possible to apply for a lower tax rate on dividends and interest."

Next Steps for the Market

The past year has seen the consummation of several major securities initiatives in the Polish market. In April, the omnibus account concept was introduced, allowing clients' assets to be grouped into one account and removing the need to provide client constitutive documents at market entry. In December, the National Depository for Securities (NDS) introduced measures into the Polish legal system that made "clearing novation" practical. Clearing novation is necessary to ensure that the central counterparty created by the NDS will be compliant with European Markets Infrastructure Regulation (EMIR) requirements.

In the spring of 2012, Citi also began offering a variety of SWIFT and other types of electronic reports for proxy voting. These include statistics on received proxy voting instructions and instruction status, email confirmation of how votes were cast and whether the resolution has been accepted or rejected, as well as a list of client securities accounts showing whether or not there is a valid proxy power of attorney in place.

Forthcoming initiatives include a change of the withholding tax procedures so that the custodian's statement is used instead of copies of the Certificate of Tax Residency (CoTR). Draft procedures were submitted to the Ministry of Finance (MoF), which then issued a draft of new regulations. If approved, operational cost and risk in the market will be reduced. Separately, the MoF is also considering changes to Article 121 of the Law on Trading in Financial Instruments. If approved, this will enable full straight-through processing of trades at the NDS, local custodian and client levels.

Finally, Binkiewicz expects further development of the derivatives and fixed income markets. He points to a few exchange-traded notes and warrants as evidence of current activity, but notes that such activity is limited to a few issues. While the government bond market is quite significant, the corporate bond is still developing. "We have a growing corporate bond market, especially in terms of the number of issues," he states, "but they are not as liquid as they could be."

Market Entry: Don't Go It Alone

As detailed above, Poland is a fairly hospitable environment to foreign investors and issuers. Just the same, investors and issuers alike can benefit from the expertise of a local partner.

In Poland, Citi has been at the forefront of the market's evolution, and indeed, has helped shape it by chairing the Custody Banks Board, heading the Advisory Committee to the Central Securities Depository and actively contributing to a number of working groups and steering committees. "We believe it is our responsibility to share our local market expertise and global market expertise to assist our clients," asserts Binkiewicz. Not only has Citi advocated for market change, but the bank has also been early to implement new products and services. In April, Citi became the first bank to offer omnibus accounts.

Having a partner on the ground can increase the chances for success for new market entrants. Binkiewicz stresses that while Citi's local presence has been critical, the firm's experience throughout the region and across the globe has allowed it to bring best practices to bear in Poland. "We know what has worked," stresses Binkiewicz, "and what has not in similar markets."

Clearing novation is necessary to ensure that the central counterparty created by the NDS will be compliant with European Markets Infrastructure Regulation (EMIR) requirements.

Citi Transaction Services
transactionservices.citi.com

1047228 GTS74055 01/13