1-2018

Singapore as an ASEAN asset management hub

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May 30, 2018 • GLOBAL ECONOMY, SPECIAL FEATURES, Global Giants, Editor's Choice, Asia - Pacific, Global Capital Markets, Top Investment Destinations

By Francis Koh and Boris Liedtke

Singapore like other ASEAN countries is also confronted with the universal challenge of retirement funding. Nonetheless, the authors argue that Singapore can address such headwind through a number of policy changes and that Singapore is uniquely placed to be the premier Asset Management Hub for the ASEAN region.

At a time when many developed countries are rightly worried about the Damocles' sword of retirement funding for their population, ASEAN countries are not spared. The region's need to plan and save for an aging population is equally compelling. Singapore may be facing a relatively brighter outlook resulting from its carefully-crafted retirement saving schemes and a well-functioning financial market. Yet, Singapore, like other ASEAN countries, is also facing the exact same quintuple challenges of: (1) increased life expectancy; (2) surging medical cost; (3) lower long-term returns from investments; (4) slower economic growth; and (5) limited options to delay the statutory retirement age. However, Singapore, like other ASEAN countries, can address these headwinds through a number of policy changes, including increased savings, better access to capital markets and enhanced return on investments to provide a larger income stream in old age. We argue that Singapore is uniquely placed to be the premier Asset Management Hub for the ASEAN region and by doing so, assist the entire region to have a more seamless and efficient capital markets, promoting financial opportunities for the individual investor to obtain better returns.

Damocles' Sword of Retirement Funding

The challenge of retirement funding is universal and is nothing new to the financial and political world. Through ever improving medical and pharmaceutical services, humanity has managed to continuously expand life expectancy in the developed and developing world during the last 100 years. In 1900, life expectancy was 47/50 years (for male/female) in the United Kingdom and the thought of saving for retirement was simply not on the minds of most people. By 1950, life expectancy had risen to 67 years but still merely just above the retirement age. Ten years later in 1960, it had increased to 71 years and continued to creep up to over 81 years around 2015. During the same period, the typical state pension age in the developed world has remained static at 65 years for men. This implies that using the 1950 life expectancy estimate, fund retirement was needed for about 2 years while by 2015, the required retirement funding would be needed for about 16 years, an eight–fold increase over a period of about 65 years..

The glass may be half-empty or half-full. We can consider the need for increased retirement funding as a "threat" or an "opportunity", i.e. the increased requirement for retirement funding would need business solutions as much as political solutions.

Expressing this long term trend in simple terms: an individual has to plan for 16 years of post-retirement funding (from 65 to 81 years old) after a period of working life spanning 48 years (from 17 to 65 years old). That is, two-thirds of our natural life would be working to pay for one-third in retirement.

What this may not take into account is that not only are individuals living longer, they may incur a higher cost of living in the retirement period. Typically, medical costs rise faster than the headline inflation rate. Therefore, there is a need to save even more for retirement. For decades, the health care costs in developed countries have outpaced the inflation rate of consumer goods by a substantial margin. In the U.S.A. during the decade 2005 – 2015, health care inflation was higher than the Consumer Price Index (CPI) every year, except in 2008. The result is that health care costs are adding about another 1.9% per annum over inflation to the need to fund for retirement. This is still benign. But, two trends – higher medical costs and longer life expectancy will interact to spiral over time. Put simply, better medical services are more expensive and thankfully allow us to live longer. As we live longer, the costs for every additional year we add to our life expectancy through better medical services becomes more costly than the previous year. It is estimated that the compounding effect of these two factors requires an additional 5% of retirement funding per year as a buffer

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Asia and the ASEAN region in particular are not immune from these trends. On the contrary, the need to save for retirement in the region is even more severe than in the developed countries. The current life expectancy in some countries in the region is relatively low but rising and rising fast (See Exhibit 1). .However, the time bomb for the region is ticking in 3 ways. Firstly, life expectancy in the region is improving much faster than it did for the comparable economic cycle in the developed countries. Put in another way, in these countries, life expectancies are improving faster because they are catching up economically and socially rather than just on medical grounds. Secondly, the demographic age structure in the region is skewed towards the “youth” (See Exhibit 2). Hence the much larger young population enjoying improved health care will lead to an explosion of population above all in the retirement age in the coming decades. Thirdly, the costs of medical improvement increasing above inflation will impact these countries just as strongly as the West without having the same level of accumulated savings.

The result of these trends are clear, the region sits on a ticking time bomb that can only be defused through substantial increase in savings for retirement. Yet the instruments for old age provision – both in the private and public sector are still rudimentary in the region with Singapore being the only exception.

Exhibit 1. Life Expectancy In Selected ASEAN Countries, USA and EU			
	Male	Female	World Ranking
Indonesia	67.3	72.7	141
Philippines	65.7	69.2	161
Vietnam	70.9	73.4	131
USA	*77.5*	*82.1*	*43*
EU	*77.4*	*83.2*	*41*

Exhibit 2. Demographic Age Structure In Selected ASEAN Countries, USA and EU			
	0-14 years	15-24 years	Median age
Indonesia	25 %	17 %	30.2 years
Philippines	33 %	19 %	23.5 years
Vietnam	24 %	16 %	30.5 years
USA	*18 %*	*13 %*	*38.1 years*
EU	*16 %*	*11 %*	*42.9 years*

The quintuple challenge, which we outlined above, applies to both developed and developing countries alike. Governments need to resolve the severe financial needs of the future. In the developed countries, a wave of changes has come about to lessen the costs for the state and corporations to provide for old age provision. Most notably in the corporate sector there was an increasing shift from “defined benefit” to “defined contribution” schemes and in the public sector simply an increase in retirement age. This has basically shifted the need to save for retirement away from these institutions towards the private individual. Governments have simply encouraged all individuals to take increasing personal responsibilities for their own retirement. In some cases, this was supported by recent legislative changes as in Germany. There is a need to have a more integrated financial industry for individual investors in ASEAN to allow for better retirement investing.

In the developed countries, the shift of responsibility from state to individual is relatively easy because it has a robust Asset Management industry, which can assist private individuals to save and invest through accessible fund management managers and investment products. The private sector infrastructure already exists to facilitate this shift for retirement savings from the public to private sector. The U.S. and European markets offer their citizens a tremendous range and choice of fund products which the Asian and ASEAN markets, in particular, lack. Thus, even if some ASEAN countries were to pass similar legislations to encourage retirement savings, the public would be challenged to find the appropriate products to invest in. There is a crying need for better access to global financial markets and retail investment products. There is a need to have a more integrated financial industry for individual investors in ASEAN to allow for better retirement investing. Hence, we advocate a common platform for the sale and purchase of financial products in ASEAN.

Singapore as an Active Regional Asset Management Hub

The multiple challenges of retirement funding should make all governments interested in planning ahead and regard these challenges as an opportunity and not just a threat. In this respect, Singapore is blessed by a number of unique features that give it a competitive advantage and an important role to create solutions for the region.

Firstly, Singapore has a well-established global financial market. It enjoys an AAA credit rating from all agencies with a stable outlook, with consistent GDP growth rates, low inflation, a stable and solid currency, a current account surplus, sustainable budget finances and substantial foreign reserves, among other attributes. It is and has been a regional hub in certain segments – FX, fixed income, derivatives, wealth management, and lately REITS. Secondly, Singapore has an excellent legal system and financial regulation with good corporate and political governance. Regulations are transparent and clear, fair and open. The financial regulator – Monetary Authority of Singapore (MAS) – is well-regarded.

These last two aspects of Singapore's competitive advantages should not be underestimated for establishing an active regional asset management hub. Unlike any other financial services, asset management is by far the most long-term focussed. Investment horizon in financial services for trading markets (equities, FX, bonds), advisory (corporate finance, private banking) and retail banking services (cash deposit, mortgages, cash transfer and custodian) are managed in seconds, months, and years respectively. Yet none of them compares to saving for retirement, which can last for 40 years during the pay-in phase (25 to 65 years) and another 20 years for drawing down the funds in retirement. The length of this service means that political and economic stability are key. Put bluntly, there is simply no point in outperforming the market through good investment decisions for 20 years when during the 21st year, there are changes in the investment regulation, tax laws or a currency event to wipe out the accumulated retirement savings. Asset management more than any other financial industry requires stability measured in decades – currency stability, tax and regulatory stability, political stability, and investment stability. Singapore can be the preferred country that can provide this credibly in the region today. Other countries could develop this in the near future.

Towards Establishing a Regional Asset Management Hub

There is a need to have a more integrated financial industry for individual investors in ASEAN to allow for better retirement investing.

By outlining the importance and opportunities which asset management offers as a cornerstone for retirement savings, combined with our list of Singapore's unique competitive advantages in this sector, we hope to kindle a broader interest to establish a regional asset management hub. However, the hardest part of these efforts is taking the first steps to achieve the end goal. How does Singapore go about establishing itself as a vibrant Asset Management hub for the ASEAN region?

Fortunately, in Europe, there may be another small country to learn from. It is Luxembourg, which has strategically started during the 1990s and early 2000s to become a regional hub without having the benefit of a large national population. Luxembourg, a country of barely half a million inhabitants, is now the second largest asset management market with over EUR 3.7 trillion assets behind only the U.S.A. How did Luxembourg manage to grow from having about EUR 50 billion of assets under management (AuM) in 1988, to EUR 845 billion in 2002 to EUR 3,741 billion in 2016, to become the leading asset management hub in Europe? (See Exhibit 3). What can Singapore learn from this development?

Exhibit 3. Development of the Luxembourg Asset Management Industry

(A) Phase I 1988-2002 AuM from EUR 53 to EUR 845bn in 14 years (CAGR 22%)		
Year	AuM (in EUR bn)	Event
1988	53	Luxembourg implements UCITS, ALFI founded
1991	103	Law on Institutional Funds
1992	167	European Union Established

(B) Phase II 2002-2016 AuM from EUR 845 to EUR 3741bn in 14 years (CAGR 11%)		
Year	AuM (in EUR bn)	Event
2002	845	EUR introduced
2007	2059	MiFID transposed into law
2010	2097	UCITS IV
2012	2384	
2013	2615	
2014	3095	
2016	3741	UCITS V

In order to understand the meteoric rise of Luxembourg into the second largest fund management market in the world, we need to distinguish between two phases during which Luxembourg outpaced its European rivals and established its unassailable lead in this sector over other financial hubs such as London, Frankfurt, Paris or Dublin. The starting point was not ideal. Given the small domestic market, Luxembourg was literally irrelevant in the 1980s as a fund management hub. Markets functioned on a "home bias" basis. European funds were conceptualised, established, registered, distributed, and managed on a national basis – German funds in Germany by German fund managers; French funds in France by French fund managers and so on. To grow from a national to a European platform, fund managers had to de facto establish offices in other countries.

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As a result of the "home bias", private investors had a limited range of products they could access, which tended to be denominated in their local currency and focussed on the domestic market. So a German private investor would typically purchase a Deutsch Mark denominated Equity or Bond fund invested in German corporations and similar a French private investor would purchase a French Franc denominated fund invested in French companies. If there was any substantial type of global diversification it was through global funds or U.S. funds investing in U.S. based assets. This meant that individuals in Europe actually increased their dependency on the well-being of the local economy. Their jobs, home values, as well as the value of their retirement funds correlated with the well-being of the economy of their own country. Regional diversification through retirement savings was literally non-existent.

Phase One Growth: Regional Distributions facilitated by Domestic Regulations in Luxembourg

RECIPROCITY – all countries were equally positioned and could sell their financial products in each other country.

The European Union tried to tackle this issue much earlier with incredible political foresight combined with a naïve understanding of the industry. In 1985, the Undertakings for Collective Investment in Transferable Securities Directive 85/611/EEC was adopted (UCITS). This was to allow for open-ended funds invested in securities to be subject to the same regulation in every Member State. So, funds authorised in one-member state could be sold throughout the European Union without the need for further authorisation, moving theoretically towards a single market for financial services in Europe. The concept was based on **reciprocity** – all countries were equally positioned and could sell their financial products in each other country. However, the reality differed from the desired impact. Countries and their fund industry remained largely domestic. The incentive to suddenly launch a fund by a German fund manager investing in French assets and selling it to Italian private investors, simply had not enough upside to transform the industry. So for a period after 1985, nothing at all changed.

In 1988, Luxembourg became the first country in Europe to translate the European directive for Collective Investments (UCITS) into local law and in the same year established ALFI, the Association of the Luxembourg Fund Industry. Together with a number of foreign and domestic fund managers, a plan was worked out analysing the competitive advantages the market would require to make use of the new regulations. It was now possible to de juro launch a fund in any European member state and through the European pass-porting mechanism to distribute it with hardly any new restrictions. Fund managers were no longer required to open offices in every European country. Nevertheless, no other country or their national fund managers identified the potential for this. De facto, the industry continued in Europe without a change – i.e. it had remained domestic.

Luxembourg realised that more than the European regulatory framework had to change. It became the only country that forged ahead. It identified the need for a domestic regulatory environment in which funds could be:

1. launched quickly;
2. merged or closed upon request; and
3. regulated with liberal investment guidelines.

In respect to the first point, fund launches were becoming more time critical. The industry saw more and more specific product ideas, which it wanted to allow investors to access quickly while the idea was new. Hot investment themes like Tiger Funds, Asian Funds, Emerging Market Funds, High Dividend Funds, etc. – needed to be brought to market while the public was interested in them and while good investment opportunities ("alpha") were still easily identifiable. However, the approval process for funds in most countries was relatively long and cumbersome. Luxembourg wanted to cut down on the time to launch a product. The financial regulator, CSSF, was staffed accordingly to allow a quick and efficient fund approval process. Market participants could now obtain approval for a new fund within a month rather than the almost 12-months period, which was common in other European markets at the time. This allowed fund managers to react quickly to new investment opportunities and hence provide a better service to their respective clients.

Additionally, the Luxembourg market realised that the industry needed to allow fund management companies to either close or merge funds that had not achieved a critical mass of investors. For a fund manager, launching a new product in Europe was a risky investment decision. Only if the product achieves critical mass by raising sufficient money from clients would it make financial sense. A product that had failed in the market could not be simply eliminated and hence consumed further resources of the fund management company (staff, money, marketing, etc.) for years and sometimes decades. So the product selection process was thorough and highly selective – hence limiting a broad product range. A market that permits more flexibility in closing or merging funds would be welcomed by the industry, as it would allow participants to easily correct failed product ideas. Luxembourg identified this opportunity and corrected domestic regulation accordingly. This allowed Luxembourg based fund managers to take more risk when launching products and then adapt to market reality quicker than in other locations. The alternatives elsewhere forced management companies to continue spending resources on small and unwanted products for years, long after they had become unviable. Consequently, Luxembourg triggered a wave of new investment products that allowed end-investors broader asset diversification.

Finally, the Luxembourg-based market participants realised that investment guidelines for funds needed to be liberal and changeable in a timely fashion. Here again other locations were extremely restrictive and conservative with typical investment guideline changes requiring months if not a full year for approval, if they were authorised at all. This was working against the trend of the financial industry of the 1990s. New products and structured investment solutions were allowing market participants to increase, reduce or diversify risks. Yet most funds could not easily take advantage of these products without going through a lengthy process to change their investment guidelines. Luxembourg identified this and streamlined the process allowing fund managers to quickly adopt their investable universe of assets as and when new products and structures were launched or markets had changed.

As a result of these three domestic regulatory changes, Luxembourg became the first choice for launching new funds in Europe. Above all, the speed to market of a new fund meant that international fund managers could launch a product first in Luxembourg, start its distribution in the whole European Community while still waiting for the approval in their home country, which they would submit in parallel. Soon, Luxembourg investment products became well-known among distribution channels all over Europe and through them to the retail investors.

It was during this phase that fund managers realised the potential of establishing a fund in a single country and distributing it throughout the continent. The regional offices were scaled back to carry out distribution functions and fund managers increasingly used Luxembourg as the launching platform for their products. Hence, the Luxembourg fund industry grew from EUR 50 billion in 1988 to EUR 845 billion in 2002 – a compounded annual growth rate of 22% over one and a half decades.

It should be noted that the firms were not required to shift their investment teams to Luxembourg. Their existing fund manager could remain in the home country of the Fund Management Firm. The Luxembourg-based fund would simply outsource the fund management function to the parent firm where the fund manager was located. This offered the industry a tremendous upside to explore synergies and efficiencies. A single fund management team in Europe could now cover hundreds of millions of potential customers throughout Europe.

Phase Two Growth: Growth of AuM facilitated by a Common Currency in Europe.

After 1988, one of the remaining hurdles that inhibited growth of an integrated European fund market was the issue of national currencies. Even when a Luxembourg Fund could be distributed in other countries, it was necessary to launch it in the respective national currencies. A French private investor was simply not yet comfortable in holding a Deutsch Mark or even less willing an Italian Lira denominated product. As a result, different share classes for each fund in various currencies remained the norm until 2002. Thus, a Luxembourg domiciled fund would have share classes denominated in different European currencies – German Marks, French Francs, and Italian Lira etc. The respective share classes were distributed in the country matching the currency. The funds, thus raised, would be exchanged into the currency of the operating fund where the fund manager would take the appropriate investment decision irrespective of the origins of the funds. So Italian Lira raised through Italian Banks distributing the Luxembourg based fund would be exchanged for USD where the fund manager of a US Equity Fund, potentially based in Germany, would invest in equities denominated in USD. The reverse was true when clients sold units in the fund. While this was not ideal, the model was obviously workable as the consistent growth rate of Luxembourg's fund industry during Phase One reflect.

The Luxembourg UCITS Model allows retail clients to diversify their investments and to have better access to a broader range of financial products.The model has many advantages for the private investors to meet their growing needs to save for retirement.

Nevertheless, the complicated currency situation often resulted in FX exposure for investors and required currency management to hedge this risk on behalf of clients. Growth of the fund market in Luxembourg could not maintain its pace until the introduction of the EUR as a common currency for the European Community. From then onwards, a fund could be denominated in a single currency (EUR) and the same share class could be distributed throughout the region. The market, then, truly became border-neutral and Assets under Management in Luxembourg grew to over EUR 2 trillion in 2007 and broke the EUR 3 trillion mark in 2014.

Thus, the Luxembourg UCITS Model allows retail clients to diversify their investments and to have better access to a broader range of financial products. The model has many advantages for the private investors to meet their growing needs to save for retirement. These include:

1. broader range of products, allowing for better asset diversification outside domestic markets;
2. timely access to new product ideas and new asset classes; and
3. a competitive and efficient market of investment products which often translates into reduced and transparent fees.

Distribution channels throughout Europe have become so accustomed to the Luxembourg fund product that nowadays it sets the European standard. It is hard to imagine that this lead over other markets will be lost in the near future unless a regulatory or political event changes the fundamentals of the industry again. It is worth noting that the compounded annual growth rate (CAGR) of the assets under management in Luxembourg grew substantially faster during the first phase (22%) compared to the second phase after the EUR was introduced (at 11%). While both growth rates were rapid, it is observed that the adoption of a common currency was not the main reason for the growth of Luxembourg as an asset management hub.

Lessons for Singapore and ASEAN

Singapore has a similar opportunity to emulate the success of Luxembourg as an Asset Management Hub and thus benefit the economies of the entire region. The fund market in South East Asia and in particular in ASEAN remains highly fragmented. Each country maintains its independent regulatory environment for its fund industry, which inhibits economies of scale. This means that retail investors throughout the region, are largely limited to locally manufactured products. This is suboptimal for an individual saving for his retirement. It does not provide broader choice, with possible higher investment returns and lower risks. Home-based investing also introduces undiversified risks. It exposes the individual investor to more country-specific risks. If his own country goes through an economically challenging time, both his current wealth and retirement savings are affected.

It is argued that the whole of ASEAN would benefit from a more integrated financial market that allows individual investors to have access to a large variety of investment products, which are easily available through a common platform. Similar to Luxembourg and the UCITS directive, the region should harmonise its fund regulations under a common ASEAN platform through reciprocity, and allow products registered in any particular country to be distributed throughout the region without restrictions. This will give individual private investors in ASEAN access to a broader range of investment opportunities, better suited for their retirement needs.

If reciprocity is available, a saver in Singapore would now be able to invest in a fund which is registered in another ASEAN country and the same for savers in other ASEAN countries.

As an example, the robust REITS industry in Singapore has allowed many private investors to gain easy financial exposure to real estate through commercial, hospital and hotel REITS and ETF investing in REITS, with small amount of funds. What is more important, there are now REITs listed in Singapore, which are investing in real estate assets overseas, in China, Hong Kong, Australia, Europe and U.S This allows individual private investors to have exposure just as easily to the real estate market outside Singapore. These REITS are not easily accessible to private investors in the rest of the region. Typically, they would have to open an account in Singapore with a Bank and the local stock exchange as well as with a broker. Then, they have to transfer money from their home currency to Singapore, change it to SGD and invest. Similarly, when they want to take the dividends back to their country, they would have to access the foreign exchange market and then wire the funds home. All of these incur transaction costs and reduce investment returns. The same goes for access to mutual funds and hedge funds established and marketed in Singapore. Harmonised regulation of the fund industry across ASEAN along a European model of UCITS, will mean better access of the private sector for retirement investments and hence a better position to address the quintuple challenges of an underfunded retirement for the regional population.

At the same time, from the other side of the picture, it is very difficult for an Indonesian or Philippine listed firm to distribute funds in Singapore to access the retirement savings of the Singapore investor. Reciprocity is not available. Only a Singapore-registered fund can be marketed freely in Singapore.

If reciprocity is available, a saver in Singapore would now be able to invest in a fund which is registered in another ASEAN country and the same for savers in other ASEAN countries. This would allow capital in the region to flow to attractive investment products wherever registered. Here the developing nations of ASEAN will have a unique opportunity to see foreign capital in the form of retail savings flowing into their country. The same would be allowed in reverse, retail savings in say Indonesia could now easily flow via the fund industry to Singapore.

Singapore is well-placed to play a role as an Asset Management centre and in close collaboration with the other jurisdictions improve the strategic position of the fund industry throughout the region.

For many countries this would also mean a growth in distribution offices by international fund managers who would now be able to distribute a product locally without the need to maintain an expensive manufacturing office making the investment frequently unprofitable thus inhibiting growth of the industry locally. International fund managers are currently staying away from some of these markets due to restrictive regulations. A regulatory harmonisation will make it financially more attractive to establish marketing/distribution offices.

In respect to the second major development that pushed Luxembourg ahead – the introduction of a single European currency – we see it as highly unlikely that a similar currency might emerge between the ASEAN countries in the near future. National and economic interests remain to dissuade this development. However, this concern should certainly not hold back the attempt to harmonise regulations following the path of Europe. Let us not forget that Luxembourg saw its strongest CAGR in the industry during the first phase even before the introduction of the single currency. There is no reason why this would be different in ASEAN.

A similar initiative is driven by market efficiency considerations, the Asia Region Funds Passport (ARFP) proposal, spearheaded by Australia, Japan, South Korea, New Zealand, Philippines, Singapore and Thailand. The intention here is to establish a regional market for collective investment schemes and to facilitate cross-border offerings between these countries. The ARFP aims to reduce regulatory duplication by establishing standardised requirements for fund operators and benefit investors through access to a broader range of fund products while maintaining investor protection. However, the ARFP is a much bolder plan to bring together a number of very well-established investment and financial markets such as Australia and Japan with South Korea and smaller markets. All of the larger participants have developed local markets and are well connected to the global financial industry. Hence, it may be relatively more difficult for regulatory harmonisation.

This paper proposes the Luxembourg model for ASEAN, with Singapore as a potential hub. It may be substantially easier to implement than the ARFP. In either case, Singapore is well-placed to play a role as an Asset Management centre and in close collaboration with the other jurisdictions improve the strategic position of the fund industry throughout the region. This will allow for a more integrated ASEAN financial market and better access to investment products for individual investors throughout the region. The end-goal is to benefit the entire region as individual investors and governments are looking for solutions to fund retirement in the years to come.