THE FUTURE OF THE INVESTMENT INDUSTRY

The main (#1) challenge and the opportunity in the capital markets today is driven primarily by inadequate supply of good companies and/or investment alternatives.

The Closed End Mutual Funds (CEMF) can play a very important, decisive, and sustainable role in providing much needed capital to the entire market as well as a leadership role in institutionalizing the investment industry. Multiple purposes can be served including providing capital to Government (Treasury) for key infrastructure projects, high potential listed and unlisted companies and simultaneously facilitating exits via listing and increasing supply of quality scrips to the markets for the retail investors. This is the case (in various forms) that revolutionized the respective investment industry for almost every developed markets including neighboring India to improve flow of funds efficiently and having a direct positive impact to the economy.

The key reason that the well managed Closed End Mutual Funds (CEMF) can take the lead is because, (1) they have a track record that is auditable and all investors (local and overseas) will have adequate reported history to evaluate each manager independently - a key criterion for any investor (local or foreign). (2) we have a serious lack of skilled professionals in the industry and well managed Mutual funds are ahead in terms of both establishing experienced teams and investment processes to take on such a critical role for the development of the investment industry. Whether we like or not, global investment industry is highly transparent and if we are serious about developing the industry, priority must be given to experienced professionals with a track record (meritocracy). However, in order to benefit the much required 2nd generation fund managers, especially those who are dedicated and serious about development of the industry, must also be supported directly by the government, donor agencies (IFC, DEG, JICA, etc.) or seed investors (including CEMFs) as sponsors at least for the short-term, and (3) finally, although small in size, the CEMF has the required base of relatively longer term capital and can make the right long term investments without stressing over providing liquidity to fund investors -- challenges undertaken by Open End Funds today. In my opinion, being in the industry for over 30 years, we are not ready yet for Open End Funds, given the underlying illiquidity as well as serious shortage of instrument options. Without realizing the key issues, the industry will most certainly not grow to its true potential and fail to contribute to the main purpose of these vehicles – generate attractive relative returns by investing in the credible companies or projects that support the overall economy. The liquidity and the low depth of the market is not only a concern for Open End Funds but also for all investors including Closed End Funds, since today any sizable trade can easily move the market adversely or can be exploited by only a hand full of investors.

In summary, Mutual funds are the only independent professionally managed and credible vehicles that are positioned to make a dent on the current investment industry challenges. In order to decisively resolve #1 issue above and serve a multi-purpose objective, the following structural and procedural changes are required immediately:

(1) We have a serious shortage of qualified investment professionals in the industry. Independent Asset Managers should be provided incentives (Financial or non-financial) to develop professional teams and processes, in order to develop skilled management teams with adequate bench strength. We must also encourage NRBs as well as experienced overseas professionals to the investment industry (similar to the RMG industry with many overseas professionals in the middle

management & leadership roles). Without qualified teams (not individuals), the investment industry will most certainly fail. Investment is all about qualified human capital and everything else is secondary and a consequence of leadership and experience.

(2) The regulators and policy makers scan play a much more accommodative and progressive role in developing the Mutual Fund industry similar to India. Approval processes for new funds can be simplified and shortened. In addition, key rules and regulations can be further simplified and be more transparent and minimize any interpretation risks for all stakeholders. Unless it is a money market fund that has high level of underlying liquid securities/instruments, all open-end funds should be converted to closed End form and/or perpetual under section 20a of securities law in Bangladesh to reduce a potential crisis. The reality is we cannot have a managed fund providing frequent liquidity to investors when we do not have underlying securities that are liquid and easily tradeable without moving the market materially. Those of us who have been around the global markets understand -- short term funding with Long term or illiquid instrument is a formula for a liquidity crisis and serious consequences for any market. Open End Funds are most certainly possible and required but not in the current market scenario with limited scrips, and no real depth of institutional investors outside of ICB. In order to create the right environment for Open End Funds much work is required by all stakeholders including regulators for developing a commercial paper market, tradable Treasury Bills market and other highly liquid investable assets including transferable Savings Certificates. To illustrate the liquidity challenge, the daily volatility of stocks in Bangladesh is more than 1.5%, therefore daily value at risk is approximately 3% (95% Confidence), implying when we buy or sell an instrument in size over 2-3 days the asset price can easily move 6-9% positive or negative. Therefore, any sizeable Open End Fund seeking liquidity in the secondary market in normal cases can have serious consequences for all investors. This is clearly not the fault of Open End Funds or the mangers but the market itself that is not prepared to absorb sizeable sale which is a basic requirement for an open end fund.

(3) We must also modify investment restrictions for all mutual funds to provide more latitude to manage risk in turbulent markets. Security Selection is the ultimate goal of any fund Manager. The 60% requirement to remain invested in stocks causes serious performance issues in the down markets because managers are forced to buy instruments that are not desirable. Security selection and asset allocation discretion is the role of a professional fund managers. Regulators can certainly intervene and facilitate but the ultimate security selection and asset allocation can be better managed by investment managers.

(4) CEMFs as an institutional investor can also play a material role in enforcing any governance challenges in listed and unlisted companies and at the same time provide market depth and liquidity to all instruments ranging from Treasuries, listed and unlisted equity. CEMFs can also finance infrastructure projects via investing in sovereign Treasury bonds backed by key infrastructure projects.

(5) Insurance companies and pension funds can be required to allocate a portion of capital to well managed mutual funds at their discretion using 3rd party and independent Consultants (eg. Cambridge associates, Mercer, etc.) similar to developed markets.

(6) In order to reduce the unjustified discount factor for CEMFs, Mutual Funds should have the option to buy back its own shares (up to 25%) at Market Price to reduce unjustified discount rate. This is

also practiced overseas to ensure that CEMFs trades close to NAV. If you own a portfolio of blue-chip stocks, the fund NAVs are accurate, and portfolio names are disclosed, I see no reason for CEMFs to trade more than 5-10% discount or premium accounting for all other investment risks and opportunities. Unfortunately, this is not the case at present due to lack of clarity in regulations, confusion among investors, lack of institutional investor base, and overall adverse market sentiment issues. I believe by providing this option alone regulators can materially reduce the discount factor overnight.

(7) At present market environment given the need for liquidity to avoid any challenges all Open End & Closed End Mutual Funds (CEMF) should be converted to perpetual and tradable funds and well performing Asset Managers should be able to issue incremental capital from new investors via a transparent price discovery process (Repeat Public Offering) via fast track approach similar to any listed companies. This is how most Closed End Perpetual Mutual Funds operate in Developed markets.

The Mutual Fund industry represent a very small fraction of the entire market (less than 1% of GDP) and without immediate actions the industry will not grow, investment professionals will leave the industry, and the industry will fail to play the desired role of being the catalyst for growth which is much needed for today and for the future of the entire economy. For instance, in India during early 1990s, after the trade and investment liberalization and aggressive reforms – both local and global fund managers played a material role in supporting high growth companies that are global brands today – including Suzlon, Infosys, WIPRO, and many more.

Many of the issues are well known and if we truly care for the future of the industry and the economy, the time is NOW to act by all stakeholders who can make a difference.

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