

The Development of Mutual Funds in Russia

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Abstract: Investment funds serve as a most effective tool to attract investments and to support stable growth of national economies. The transition of Russian market from the speculative to the investment stage can be accomplished through accelerated development of the mutual investment sector. This study provides a brief review of trends in the development of Mutual Investment Funds (MIF) in Russia during the last 5 years and substantiates the sustainable usage of the point rating system for the performance appraisal of a management company focused on structural transitions in the field of financial intermediation. The main aim of the study is to appraise the performance of investment funds and their managerial system by means of point rating methods. The global financial crisis affected Russia's collective investment system, revealing such problems as low quality risk management and lack of information transparency. Simulation study of the overall index based on point rating approach to determine the trends in the development of the system of MIF management in Russia is topical for its performance appraisal. This economic tool appears to be helpful in disclosing and assessing structural changes in the field of trust management in terms of types, styles and other spheres of mediation.

Key words: Investment funds, qualified investors, foreign investments, performance appraisal, styles

INTRODUCTION

Investment funds serve as a most effective tool to attract investments for the national economy stable growth. The transition of the Russian market from the speculative to the investment stage can be accomplished through the accelerated development of the mutual investment sector. There is obviously one serious problem that sets back further development of collective investments, i.e., a fairly low level of the investment funds management. In this connection many Russian investment funds have to face certain problems linked with the investors' finance attraction. Therefore, the substantiation of the proposed methods for the performance appraisal of Russian investment funds management which allows solving a task complex determined by the specific character of the present day national economy standing, appears to be both timely and topical.

The effectively operating segment of collective investment turns out to be among the most important prerequisites for the country's stable economic growth.

The importance of the segment can hardly be overestimated for it fulfills complex social and economic tasks (Ramos, 2009).

The problems of setting up favorable investment conditions for the investors to operate on the national economy market through investment funds make the subject matter for scientific research in Russia and in other countries (Fama and French, 2008; Cooper *et al.*, 2005; Gallagher, 2002; Ivanov, 2009; Kharchenko, 2010).

Berk and Green (2004) claim that the level of investment funds development is at large connected with the duration time and stability of their performance. Economies of scale existing in investment funds and making itself evident in distribution of the management authority provide for the formation of relations which guarantee respectable payments to shareholders and managers. A positive correlation between the fund's activities and its level show the effectiveness of the economies on scale approach (Berk and Green, 2004; Otten and Bams, 2002).

However, Perold and Salomon (1991) who propose an idea that the considerable level of a fund can cause a

harmful impact on its performance, considering commercial expenses and the impact on the pricing of the assets being bought. This means that small funds enjoy considerable advantages over major ones for the former can participate in the bidding without considerably affecting the assets price. Chen *et al.* (2004) also support this opinion. They believe that a small-scale fund may find it easier to invest their financial resources to the best advantage, whereas the insufficient liquidity often forces major funds to invest into relatively worse-quality assets (Otten and Bams, 2002; Perold and Solomon, 1991; Chen *et al.*, 2004).

MATERIALS AND METHODS

The study objective is to appraise the performance of investment funds and their managerial system by means of point rating methods. Data included into the analyses comes from Bank of Russia, Image Factor Analytic Agency, Moscow Exchange, Invest Funds Group Cbonds. The study assesses the basic development trends in area of investment environment in the Russian Federation (investment funds, assets price and structure, costs of shareholdings, etc. In this study, we will dwell on the research issue of the point rating approach potential for the appraisal of development tendencies in the Russian management system of MIFs. Among the notable research undertaken lately in this field it is important to single out the study carried out by Kharchenko (2010) who proposed a number of parameters to form an integrated development index. The proposed parameters, estimation criteria and certain approaches require however in the opinion, further specification to appraise the trends development of the investment funds management in Russia.

The choice of the parameters, defining the trend is being made through expertise and implies the introduction of the funds management market figures potential and capacity, also availability of the funds, etc. The overall index is defined in points and looks as follows:

$$I = \sum k_i \times w_i$$

Where:

k_i = The value of the i parameter in points

w_i = The weighting factor of the i parameter ($\sum w_i = 1$)

As a result of summing up the points, the appraisal score can be obtained and compared to a similar appraisal score for a foreign financial market or to a similar score for the Russian financial market obtained for another period of observation.

The integral index proposed by the researchers is actually an information model for assessment of the

implementation of the target system of MIF trust management. Target indicators are defined by the several development forecasts of financial intermediation sector such as investment strategies and road maps or others. By comparing the values of the integral index for several years, one can reason about general development trend (growth dynamics, efficiency of investment funds' activities, etc.).

The lack of indicator's positive dynamics can signal about the negative impact of market mechanisms on the analyzed segment of financial intermediation, especially in terms of financial crisis. Also, it can signal about an inconsistency in the investment funds' operations and about a requirement for the new governance instruments.

RESULTS AND DISCUSSION

Development of the investment funds segment in the russian federation: Savings pattern in Russia is characterized by a substantial share of current savings intended for buying durable goods or for retirement. The main savers are people from the middle class. Bank deposits, particularly in foreign currency are considered to be a reliable saving instrument in the country; currency on deposits was purchased to be sold later.

Recently, analyzed data show that the share of savers in Russia has not undergone significant changes during the last 7 years and includes approximately, the third of the population. The rate of deposit growth remains stable and is about 19% per year. However, the segment of deposits in rubles tends to increase faster than that in hard currencies. Based on preliminary estimates, the household saving ratio in cash and on deposits equaled 7% in 2012 which is a bit below 7.4% the saving ratio in 2011 (Table 1).

Conceptually, collective investment through MIF and JSIF is close to the concept of (collective investment scheme) in European terminology or to that of mutual trust in American terms. It is generally recognized that every country has a list of its own specific collective investment schemes and institutional investors. Russia is not an exception in this aspect (Cooper *et al.*, 2005; Kharchenko, 2010).

Table 1: General assessment of investment funds in Russia by 11.04.2013

Name of institution	Total number	Active assets in bn RUB
Mutual investment funds including	1579	562.9
Open-end IF	458	106.3
Interval IF	57	7.7
Closed-end IF	1064	448.9
Joined stock IF	5	5.8

Bank of Russia: http://www.cbr.ru/publ/God/ar_2012.pdf and Deposit Insurance Agency: <http://www.rusbanks.info/article/Analiz-rynka-vkladov-fizicheskikh-lic-v-2012-godu.html>

The harmonizing of Russian regulations and requirements could surely help a number of investment institutions (managing companies) get over geographical boundaries and attempt to enter foreign markets, particularly the European one. Present legislation provides for the MIF structure presented in Table 2.

In the end of 2007, the investors on the Russian financial market were divided into two groups: qualified investors and others. This division allows distributing risks among the market participants more rationally. According to the information available, profitability of rental MIFs is characterized by skewed distribution and unstable dynamics which is also characteristic of real estate funds.

The qualified investor as defined by Russian laws is in many ways similar to their European analogues. But, the adequate assessment of how the European legal ideas were incorporated into Russian legislation demands specifying the distinctive features of accredited investors' institution in Russia. Firstly, this institution is universal for the entire financial market not for securities market only. Under the circumstances, this is the best solution as it allows for testing the adequacy of world regulation standards to Russia's financial services market. Secondly, according to the law the list of Russia's qualified investors is closed-up (without taking into consideration some potential (special) investors of the future when federal laws might change).

In Russia qualified investors have the right to work with investment funds designed especially for them. Investment funds for qualified investors in Russia are represented by such categories as real estate funds, rental funds, venture funds, mortgage funds, credit funds and other closed-end MIF, >2/3 of their total assets are held by real estate and rental funds. The investment funds serving qualified investors have the advantages.

In May, 2012 State Duma's Financial Market Committee approved of establishing a new type of investment funds in Russia, so called Exchange-Traded Funds (ETF). The difference between index MIFs and

ETFs is that ETF securities can be traded on the equity market like ordinary stocks. To have ETFs traded the RF government has to introduce some amendments to Russia's legislation. The improvements in the legislation regarding units circulation in organized trading sessions have already been made. It is also necessary that government acts on the funds' asset composition and structure be added to the legislation (Table 3).

The analysis of MIFs infrastructure costs and of premiums and discounts charged on purchase and redemption by both management companies and their agents is indicative of insufficient saturation of the investment funds market. Management fee varies from 1-5% (without VAT) and no correlation can be found between management fees and assets or the number of MIFs under management.

The same situation is with respect to costs paid at the expense of the MIF's property. In total, maintaining the MIF infrastructure costs the investor 3-11% a year and no clear PATTERN in the amount of remuneration can be seen. Similar situation is with discounts and premiums.

Table 2: Asset prices and structures depending on MIF type as on 11.04.2013, bn rubles/+

Categories (funds)	MIF type		
	Open-end	Interval	Closed-end
Bond	35.5/+	3.2/+	41.0/+
Stock	54.4/+	0/+	0.02/+
Hybrid investment	9.0/+	3.6/+	66.1/+
Index	2.9/+	0/+	0/+
Money market	1.7/+	0/+	0.03/+
Funds	2.7/+	0.0/+	0/+
Commodity market	-	0.9/+	0/+
Hedge	-	*/+	*/+
Mortgage	-	-	1.9/+
Venture investment	-	-	*/+
Real estate	-	-	169.9/+
Direct investment	-	-	*/+
Rental	-	-	169.7/+
Credit	-	-	*/+
Art treasures	-	-	0.3/+

According to the data from the (Image-Factor) analytic agency, (Cbonds Invest funds)» group Cbonds invest funds. Conventional notation: (+) such MIFs are stipulated by Russia's Law, (-) such MIFs are not stipulated by Russia's Law. */ The information has not been revealed

Table 3: Traded ETF on Moscow stock exchange on 28.1.2014-31.1.2014

Types of funds	Underlying asset	No. of transactions per day, units	Average weighted price, roubles
FinEx Tradable	Eurobonds of the Russian corporate issuers	3	1 023.00
Russian Corporate Bonds UCITS ETF (RUB)			
FinEx Physically Held Gold ETF (USD)	Gold bullions	14	316.94
FinEx MSCI Germany UCITS ETF (EUR)	MSCI Germany index	5	1 137.00
FinEx MSCI USA Information Technology UCITS ETF (USD)	MSCI USA information Technology index	4	1 126.10
FinEx MSCI Japan UCITS ETF (USD)	MSCI Japan index	2	1 007.50
FinEx MSCI Australia UCITS ETF (USD)	MSCI Australia index	2	933.90
FinEx MSCI USA UCITS ETF (USD)	MSCI USD index	1	1 103.00
FinEx MSCI United Kingdom UCITS ETF (GBP)	MSCI United Kingdom index	2	1 108.80

Moscow Exchange <http://moex.com/>

There are no common strategies in attracting clients: some MIFs promote sales through agents, others through the management company yet others do not have discounts and premiums at all. But usually when funds are committed to 6 months or longer horizon, discount in redemption fee can be substantial. It is worth to note that there are no MIFs that work exclusively for either corporate or individual clients. If we try to draw the line, it is very thin and the difference has everything to do with the minimum investment required for buying a unit (share) in particular MIFs. If we draw a line at 25,000 rubles of minimum investment it then turns out that 3/4 of MIFs are ready to cater to a private investor crowd.

The MIFs market divides into two categories: passive companies and aggressive ones. The sleeping market includes asset management companies taking bidding position: they cut funding, lay off staff and curtail diversification programs and so on. Aggressive companies in contrast, launch promotion programs, stimulate loyalty and increase advertising space. In other words they expand their information field by expanding their market share.

At the present moment MIFs' investment declarations are written just as a formality and do not give complete understanding of the fund's investment policy. Thus, control over the management company can not be exercised in full. To minimize investment risk an investor should decide on appropriate balance between risks and profitability. If an investor desires moderate income provided that he can leave the fund any time he wants then the optimum decision is an open-end fund an open-end fund is the way to go because its assets are highly liquid. Also, a management company's reputation can mitigate somewhat the risk of negligence or fraud. Another important factor is a company's ability to perform

on a falling market. According to the analysis by no means all managing companies are prepared for it. Table 4 helps to assess the performance of a number of MC with different ratings.

Choosing a MIF, the investor should consider not only the last year results but the fund's historical performance. Risk averse investors should invest in funds with at least a 3 years history. Analyzing past performance, it is necessary to realize that a high return in the past is not a guarantee of success in future.

The secondary market is not suitable for all funds. At the present days, regular traders on the market are closed-end equity funds, real estate funds and index MIFs. At the moment, the units of slightly over 30 MIFs are traded in the stock market, 70% of the former are unlisted.

Performance appraisal of russian funds management of MIF:

While comparing the indices of MIFs in Russia and other countries, the funds classification applied in other countries should be taken into account. To a certain extent open-end and interval investment funds can be compared to MIFs of the USA and to UCIT funds which belong to collective investments. Other types of funds are rather often referred to funds of alternative investments, hedge funds and REITs the statistic data on which is compiled on a separate basis.

The global financial crisis has made a dramatic impact on the developing countries' markets, Russia not being an exception. In these circumstances the Russian market of collective investment does survive and strives to develop. Many researchers tend to appraise the management system performance whilst applying various approaches. They are doing so in order to find indices for the performance effectiveness and to make the right choice of

Table 4: Maximal decrease in the cost of a shareholding at some Mutual Investment Funds (MIF) from 14.11.2012-31.10.2013

Name of MIF	Investment unit price change (%)	Maximal decrease in the cost of a shareholding (%)	Rating MC MIF according to the national rating agency
Alfa capital consumer sector	+1.26	8.39	AAA
Alfa capital oil and gas	-5.58	12.29	AAA
VTB-telecommunications fund	+9.91	4.56	AAA
VTB-global dividend fund	-0.95	4.33	AAA
Otkritie-shares of china	+1.55	2.52	AAA
Otkritie-top 10	-7.22	12.98	AAA
Raiffeisen-information technology	+3.47	7.59	AA+
Raiffeisen-power energy	-12.96	19.05	AA+
Sberbank-first-tier bond fund	-3.48	7.99	AAA
Solid globus	+3.74	1.91	A+
Solid invest	-7.17	9.41	A+
Troika dialog-agriculture sector	+1.25	3.85	AAA
Uralsib russian finance	-6.68	12.84	AAA
Uralsib infrastructure and communications	-6.57	10.54	AAA

Compiled by researchers and is based on the data from Invest Funds Group Cbonds <http://pif.investfunds.ru/funds/index.phtml>, Moscow Exchange <http://moex.com/>

Table 5: Point rating grading scale for the performance appraisal of funds management

Trends	Weighting factor
Ratio of the investment funds' net assets cost to GDP	0.15
Number of management companies	0.10
Total number of investment funds	0.10
Amount of the attracted finance for investment	0.30
Number of management companies operating on the organized market	0.10
Exchange traded securities of the investment funds	0.15
Number of the investment funds allocated by Russian management companies on foreign markets	0.10

Table 6: Calculation method of overall index

Indicators	2009	2010	2011	2012
Ratio of the investment funds' assets cost to GDP	1.00	1	0.00	0.00
Total number of investment funds management companies	1.00	1	0.00	0.00
Number of investment funds	1.00	1	1.00	1.00
Amount of attracted finance for investment	1.00	1	0.00	0.00
Number of management companies operating on the organized market	1.00	1	1.00	1.00
Exchange traded securities of the investment funds	0.00	1	1.00	1.00
Number of the investment funds allocated by Russian management companies on foreign markets	0.00	1	1.00	1.00
Overall index	0.75	1	0.45	0.45

Reaserchers' own calculations

the most appropriate manager: for this they base their work on bench marks, on structuring sustainable ratings of the investment funds and their management companies, applying the alpha ratio and defining the development vector on the grounds of point rating approach, etc.

In this study we will dwell on the research issue of the point rating approach potential (Kharchenko, 2010) for the appraisal of development tendencies in the Russian management system of MIFs (for details see the methodology) (Table 5).

The criterion (the changes threshold) is taken into account in calculating the trend of changes (positive or negative). It is widely held that for the dynamic markets it can stay at the level of 10% although, we suppose that the value of the major changes threshold is at large determined by the growth dynamics of the country's economic development and its innovation constituent.

In the opinion for the Russian economy the following correlation of the number of points and the appraisal of the funds management system can be deemed reasonable, i.e., the total sum of <0.2 points is acknowledged as the 'regress', the sum between 0.2 and 0.5 points is the 'slow development', the sum between 0.5 and 0.7 points is the 'steady development' and the sum of 0.7-1.0 points is the 'dynamic development'. As a result of all the calculations for the period between 2009 and 2012, the overall development index of trust management in Russia was 0.75-1.0 in the years 2009-2010 and 0.45 in 2011-2012, respectively. The calculations were conducted on the basis of the data provided by the National League of Management Companies, Ros Business Consulting and Moscow Exchange, regarding the changes threshold at 5% (Table 6).

The overall index for the management development of investment funds can be supplemented with parameters which reflect structural changes in the segment of financial intermediation in question. In order to appraise structural transitions the ratios of change for types of financial intermediation for investment styles and for the mode of investment funds securities trading can be applied.

At the present time, there are different approaches to the integral index selection and its components to determine the development trend of investment funds' trust management. In researcher's opinion, the suggested approach (based on a system of point rating appraisal of trust management) reflects the relationship between quantitative and qualitative parameters of different trends and provides the basis for a comparative analysis of the estimated values in the segment of financial intermediation in different countries.

CONCLUSION

On the base of results coming from the study the following summary can be highlighted. Regarding secondary market development, we can conclude that the main factors which hamper the development of a liquid secondary market for trading units are:

- It is difficult to attract investors interested in intraday speculations because the investors of open-end MIFs are rather conservative en masse and those inclined to risk prefer to play on the equity stock exchange, rather than on the unit marke

- The volume of MIFs' assets delivered for trade does not ensure liquidity of the secondary market. To make spreads no >0.2%, the effective capitalization of the equity market reaches 2.5 bn rubles and more. The average NAV of MIFs is about 600 m rubles and this is not enough to support such spreads and liquidity on the investment units market
- As mutual correlation of most MIFs' assets on the domestic market is rather high, diversification of assets is problematic and this slows down the growth of the market participants
- Buying and selling units through management companies is easier and cheaper than to trading them on the stock market because of low efficiency of market trade. Spreads on some MIFs can reach as much as 5-6%, traders can often quote only one side (bid or ask)
- Gaps in legislation, low investors' awareness about opportunities and ways of investing in MIFs also create significant obstacles for the market development

Regarding managerial system and its evaluation, the results coming from point rating grading scale analyses and overall index calculation provide the following findings. The overall development index of trust management in Russia was 0.75-1.0 in the years 2009-2010 and 0.45 in 2011-2012, respectively.

To summarize the current situation the following can be stated. The modern global financial crisis affected Russia's collective investment system, revealing such problems as low quality risk management by managing companies and their lack of information transparency.

Simulation study of the overall index based on point rating approach to determine the trends in the development of the system of MIF management in Russia is topical for its performance appraisal. This economic tool appears helpful in disclosing and assessing structural changes in the field of trust management in terms of the types, styles and other spheres of mediation.

The proposed information model lets us to determine the state of the financial intermediation segment that covers the trust management of individual country's investment funds. In the researchers opinion this model can be applied to identify the development trend in the countries that have added the structures of investment funds' trust management to their financial systems.

Researchers are going to apply their further research to explore the institutional structure of the trust management of investment funds and primarily, its informal constituent. This approach aims to explore and explain the boundaries of the trust management development. As a factor forming the model, we propose the institutional structure of the trust management, ranked on the level of financial market development.

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