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THE ENRONIZATION OF

RUSSIA

Young rich want more

Russia's domestic wealth management industry has a long way to go

Russia's wealth is racing ahead of that of its eastern European counterparts, and its youthful rich will change the investment landscape. A report by wealth management think-tank Scorpio Partnership shows that Russian high-net-worth individuals control about \$325 billion in assets, around \$70 billion more than those in Poland, the next wealthiest country in the region.

For fund managers and private banks, the country offers significant opportunities.

"Over recent years we have witnessed increased activity in the financial services sector as regard the promotion of private banking services to Russian clients," says Ekaterina Lazorina, a partner in the financial services practice at PricewaterhouseCoopers.

"Wealth is owned and predominantly rests in the hands of young entrepreneurial and professional nouveaux riches residing in the major centres across the region," says Scorpio's managing partner Sebastian Dovey. "They are the engine room of future growth and they are already showing strong signs of interest in broader wealth management solutions."

This young wealthy investor base could change the shape of asset allocation in

Russia. Ted Wilson, a consultant at Scorpio, says that Russians with wealth of \$1 million to \$10 million tend to have their onshore wealth allocations 30% invested in domestic real estate, with 25% in domestic cash, 25% in offshore cash, 10% in domestic fixed income, and 10% in international real estate or emerging markets fixed income. Offshore wealth tends to be invested in Austria, Luxembourg, Switzerland and the UK. Increasing interest in venture capital and hedge funds by younger, more entrepreneurial wealthy Russians could push more money offshore.

At present Russia's domestic hedge fund market is underdeveloped. John Winsell, Davies is managing director at Diamond Age Capital Advisors in Moscow. He says that Russia has few pure hedge funds, but expects the market to grow.

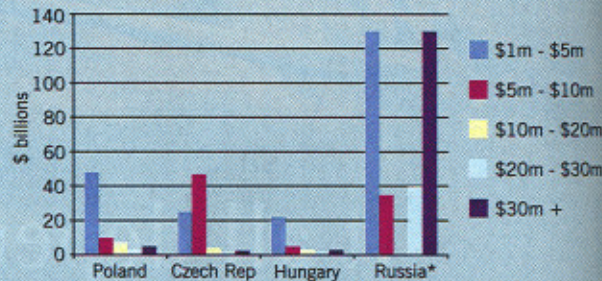
"Russian hedge funds are essentially loosely regulated limited partnerships domiciled offshore and, as such, their regulation

and structure is not uniform. You could essentially run a long-only eastern Europe corporate bond fund, and call it a hedge fund in Russia," says Davies.

He continues: "The great majority of Russian hedge funds are actually just long-only equity mutual funds that charge a 2% management fee and a 20% performance fee, similar to actual alternative investment structures in other markets. In the extreme, many of these funds are simply replicating the broad Russian market by running quasi index funds that have all the characteristics of a synthetic RTS mirror portfolio while charging a hedge fund type call option on the Russian market to the investor, which comes to the manager for free."

As investors become more familiar with the concepts of hedge funds, they will demand proper hedge funds in Russia or will simply put their money elsewhere.

WEALTH IN CENTRAL AND EASTERN EUROPE



Source: Scorpio Partnership

*Russia has \$40bn in the \$10m to \$30m bracket