CIC and BlackRock team up; Fatca and Asia; paying the price for short-selling in Hong Kong…

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China's sovereign-wealth fund, CIC, is believed to be **teaming up with** the **world's largest money manager BlackRock Inc** to a start a fund that will focus on **investing in Chinese companies and businesses that sell products in China** reported *Bloomberg* this week. The companies themselves, however, would be based outside of China according to people familiar with the matter. This might involve co-investing with Chinese companies in their international acquisitions. Right now there actually seems to be a trend in Chinese companies de-listing from foreign exchanges and moving to list on the likes of the Shanghai stock exchange – let's face it, there've been numerous allegations of accounting irregularities in the last 12 months, sparking a great deal of interest in shorting Chinese stocks among hedge funders. The joint venture between CIC and BlackRock will be managed by Liu Erh-fei, currently chairman of Bank of America Corp's brokerage operation on the mainland. **Laurence D Fink, BlackRock's chairman and CEO**, noted last year that the firm was interested in expanding in Asia where investor deposits were "slower than we would like". This new JV would seem to signal such a move; it could be a winning strategy for BlackRock as CIC is one of the world's biggest SWFs and will surely open up countless doors. According to its latest annual report, as of end-2010 CIC had USD410billion in assets.

Moving on to regulation, a report by *AsianInvestor* suggests that the **majority of Asian hedge fund managers have yet to fully appreciate the implications of the controversial US Foreign Account Tax Compliance Act (Fatca),** particularly with regards to their operations. Even though the Hong Kong Investment Funds Association held a Fatca event last month to discuss key issues, it appears the topic is still largely off most people's radar screens. "The impact on this industry in Asia will be hard," said Kevin Chan, COO of Baring Asset Management (Asia). "No one yet knows the full extent to which this will impact the industry in Hong Kong, Singapore or other markets." Speaking at an AIMA seminar in Hong Kong, Angelica Kwan, a partner at PricewaterhouseCoopers, said that a lot of smaller funds don't realise that "a 30 per cent tax penalty that hits you is based on US assets not US investors". "A lot of funds do not realise that if you don't have US investors, you might still have to be Fatca compliant," Kwan was quoted as saying. Fatca is scheduled to be implemented in 2014 and starting from 2017, any fund that gets paid by another financial institution complying with Fatca, could be hit with a 30% withholding tax, even if it doesn't hold US assets, adding even greater complexity to what is already a pervasive piece of legislation.

Despite the fact that the number of Asian hedge funds engaged in lending has risen 40 per cent since the credit crunch, *Data Explorers* this week noted that **the cost of short selling in some parts of Asia like Hong Kong remain devilishly high where demand continues to outstrip supply**. The firm has seen the number of Asia-domiciled lending funds climb from around 2,500 to nearly 3,500. As mentioned at the top of this article, interest in shorting China stocks last year was huge. The China Securities Finance Corp was set up last October as a centralized securities lending platform in response to this growing demand, enabling it to borrow securities or cash from asset managers, insurance companies and other beneficial owners, and lend securities or cash to brokers.

Data Explorers point out that according to research by CITIC Securities, an extra 188 stocks (on top of the existing 90) became borrowable as a result of the newly formed Securities Lending market, noting that the stock on loan increased 10 per cent in March. Supply is less concentrated among Agent Lenders in Australia, Hong Kong and Japan, with Hong Kong in particular having seen its inventory concentration ratio fall from close to 16 per cent in Jan 2007 to less than 13 per cent currently. What this means is that the fees to borrow Hong Kong stocks are rising and that demand continues to outpace supply.

Finally, sticking with the theme of shorting, *Reuters* this week reported that **Macquarie's Asia hedge fund had exited its short positions in Indian single stock futures** because of proposed new tax rules that could erode investment returns. To get around the issue, the fund is shorting exposure to India through a futures contract on the Singapore Exchange linked to India's 50-share NSE index (aka 'Nifty'). As further evidence that exposure to India is being pared back in response to the forthcoming tax rules, the USD1.5billion Macquarie Asian Alpha Fund also cut its long exposure to the sub-continent last month.

Foreign investors have two key concerns regarding Indian tax provisions: the first gives India power to retroactively tax the indirect transfer of assets while the second relates to tax evasion via the General Anti-Avoidance Rule. Investors from countries with special tax exemptions with India would have to prove that they didn't intend to avoid tax, creating additional paperwork that foreign investors like Macquarie likely won't appreciate. The fund's **portfolio manager, Nick Bird**, told clients in an investor letter that the fund could become liable for capital gains tax on unrealized gains after 1 April. Commenting on having to exit the single stock futures positions Bird was quoted as writing: "These changes were unfortunate given we prefer, for risk control reasons, to gain our short exposure via individual stocks rather than index futures contracts."

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