Unlocking China's Domestic wealth

By Lawrence Au*

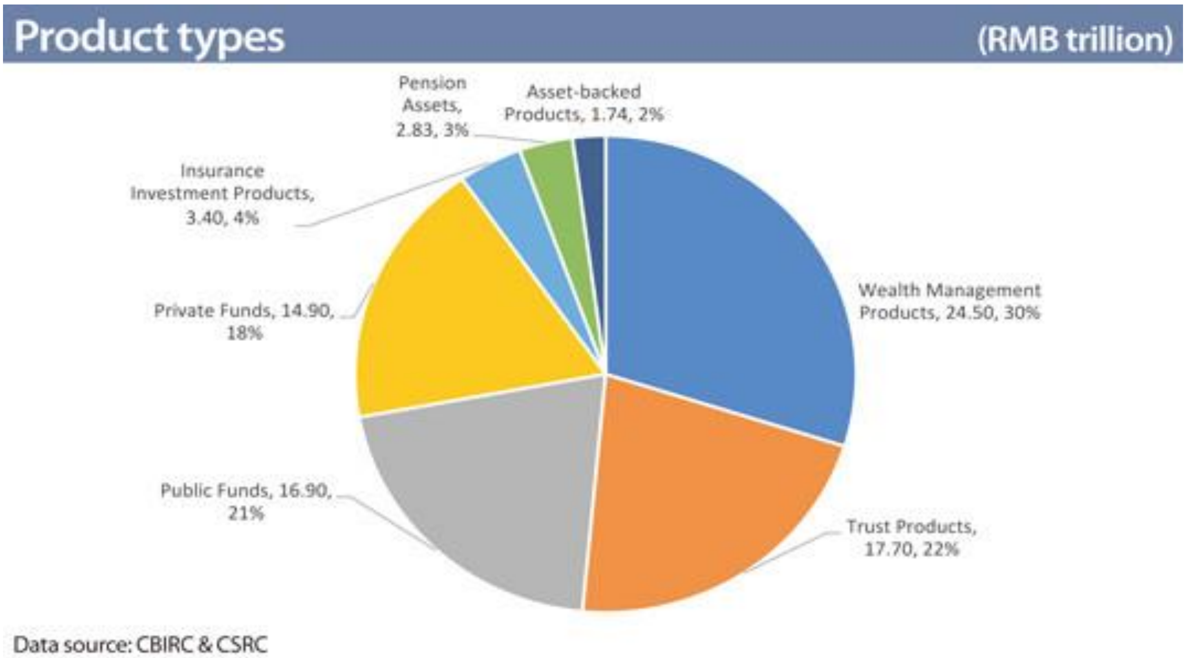
Foreign fund managers now have several routes to tap the vast China market

China's asset management industry is much more vast than the 16.9 trillion RMB (US$2.39 trillion) mutual fund market which tends to be the focus of many foreign fund managers. The industry has developed a depth and breadth that goes far beyond mutual funds over the past two decades.

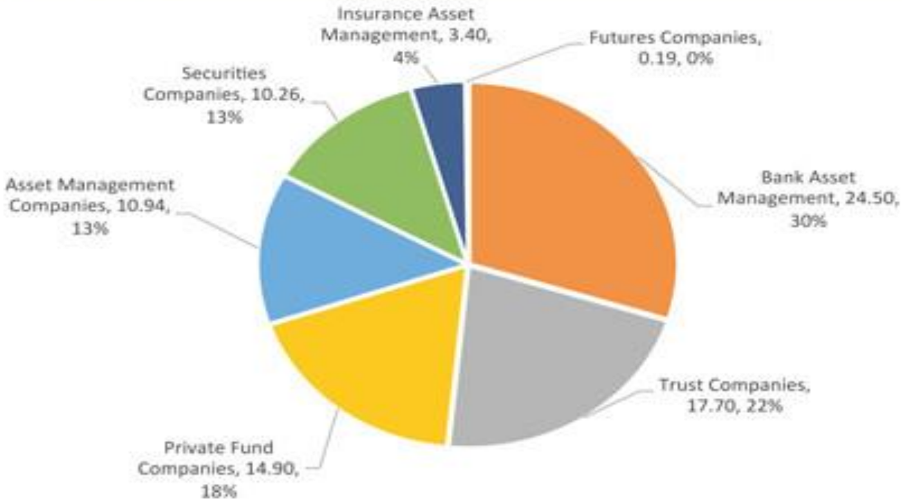
Based on combined data from China Securities Regulatory Commission and China Banking and Insurance Regulatory Commission, the industry's total assets under management was 81.9 trillion RMB as of end-June 2020, almost five times more than just the mutual fund market.

These assets are under management by a range of players, including asset management firms, private fund companies, securities firms and their asset management units, futures companies, banks and their wealth management units, trust companies, and insurance asset management companies that are under the supervision of the two regulators. Although there could be some overlap of the numbers in the various sectors, the total figure is nonetheless staggering.

Wealth management products account for the biggest market share of 30%, or 24.5 trillion RMB. Trust products are next, at 22% or 17.7 trillion RMB, with public funds close behind at 21% or 16.9 trillion RMB.



Market players (RMB trillion)



Data source: CBIRC & CSRC

Chinese regulators have published a series of regulations on bank wealth management, public funds, private funds, investment trusts and insurance investment management over the past 20 months. These further clarify the business scope and governance measures for each sector, and eliminate regulatory arbitrage.

The direction is very clear. Industry participants are required to standardise their asset management businesses, invest a large share of funds in market securities, refrain from irregular practices such as channel businesses and investment in trust loans and account receivables for financing purposes, and bolster their professionalism.

New phase

After two decades of growth, the asset management industry is now set for a new phase of development, focusing on segmentation and specialisation to move towards the fiduciary advisory model.

There are a number of drivers for this shift. Firstly, there's the increase in personal wealth as the economy continues to grow. China's gross domestic product reached 99 trillion RMB in 2019, with per capita income of 15,700 RMB. And this year, in spite of the challenges of the coronavirus pandemic and a worsening relationship with the US, China's GDP is expected to grow 4% or more, with per capita income increasing proportionally.

As investment literacy improves, a portion of the 63 trillion RMB household savings in the Chinese banking system is expected to gradually shift into investments.

At the high end of the personal wealth spectrum, there were 4.47 million individuals with an investible net worth of more than $1 million last year in China, and 109 million with net worth ranging between $100,000 and $1 million. It is estimated that these groups will swell by 8% a year through 2025. And as they become more confident investing in financial assets, they are increasingly looking for alpha generation through multi-asset strategies, offshore exposure and innovative products to build their investment portfolios.

Another key driver for the industry shift is an ageing population, partly the result of China's one-child policy, which only ended in 2015 after more than 35 years. The share of the population aged 60 or older is expected to rise from 18.1% in 2019 to 28% in 2040, according to official estimates.

Government reforms have encouraged pension assets to grow rapidly. Pillar two enterprise annuity schemes, introduced in 2004, have grown to 1.86 trillion RMB and occupational annuity schemes, introduced in 2009, have expanded to 650 billion RMB.

Pillar three private pension schemes were introduced two years ago, and the asset growth is expected to gather pace with improved tax-deferred policies.

Growing capital markets

Meanwhile, China's growing domestic capital markets have moved up a gear to enable a wider array of investment approaches and strategies.

As of end-June, there were 42,616 domestic debt issues outstanding, valued at 107.7 trillion RMB. And the combined market capitalisation of the Shanghai and Shenzhen stock exchanges stood at 64.9 trillion RMB with 3,893 listed companies, and total monthly turnover of 14.5 trillion RMB. The Shanghai Stock Exchange Science and Technology Innovation Board. China's challenge to Nasdaq for listing promising home-grown technology and startup companies, began trading in June 2019 and now has more than 140 listed firms and a market capitalisation of 2.79 trillion RMB.

In addition, average turnover of Hong Kong-listed stocks in southbound cross-border trades via the Stock Connect programme has topped HK$20 billion ($2.58 billion)

But the development of financial futures, options and other derivatives is still in the nascent stage.

All these forces are driving the industry to become much more balanced between retail and institutional investments. Moving towards a fiduciary advisory model through segmentation and specialisation is the logical next phase in the industry's development.

More options

Foreign fund managers now have multiple options to enter China following Beijing's recent moves to further open up the financial markets. They could set up fully-owned or majority-owned asset management, private funds, securities, and futures companies, or take stakes in bank wealth management units, pension management companies or insurance asset management companies. The choice will depend on their particular level of ambition, capability, strategy, and long-term commitment.

J.P. Morgan Asset Management is buying out its joint venture partner China International Fund Management's 49% stake in Shanghai International Trust. Meanwhile, the JPMorgan Chase Group is setting up a wholly-owned securities company in China, in addition to its banking unit that has been operating in the country for more than a decade.

BlackRock Inc. is setting up its own asset management company for mutual funds, and also forming a three-way wealth management joint venture with Singapore's Temasek Holdings and China

Construction Bank. And Vanguard is reportedly returning $21 billion in managed assets to several Chinese government clients to focus on low-cost funds for individual investors.

Foreign insurers such as Generali, Prudential Plc, Manulife, and AIA are reported to be in talks with the authorities to enter the private pensions sector, encouraged by regulatory approval last year for Heng An Standard Life, a joint venture between Standard Life Aberdeen and Tianjin TEDA International, to establish a pension insurance company.

Setting up a wholly-owned asset management company is a tempting option for foreign fund managers because of the opportunity for full control and, in some cases, after going through difficult joint venture experiences. However, this alone may not necessarily gain them mileage because brand building, establishing a performance track record and client acquisition in the domestic market would be a challenging and prolonged process.

A multi-pronged strategy built on a variety of legal structures, partnership arrangements, and investment propositions would better position them for sustainable growth and success.

They should also expect stiff competition from local players. In every sector, there is increasingly sophisticated and technology-driven local competition with well-established infrastructure, network, business scale, and thorough understanding of the local investor culture and regulatory environment.

There will be no short cuts. Foreign fund managers need to do the hard work, build trust, grow their presence, develop local talent, and hone their skills to meet market needs in order to have a chance to create a genuine cutting edge to unlock China's domestic wealth.

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***** This article was published in Asia Asset Management's November 2020 magazine under the title 'Unlocking wealth'***