FLEISHMANHILLARD 2020

THE FUTURE OF ASSET MANAGEMENT IN CHINA 2020

FLEISHMANHILLARD

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Executive Summary

In any other year, the market-opening measures implemented by China to develop its asset management industry would have garnered more attention. Thanks to the COVID-19 pandemic and US-China trade tensions, game-changing measures such as the scrapping of foreign fund management ownership limits have been overshadowed.

The sector has changed discernibly in the past year and there is more to come over the next 12 months. At the same time, it will be fascinating to see how local investors respond to the retail fund launches by foreign asset management firms.

In China, assets under management (AUM) will surpass US$2.6 trillion by the end of 2020, up from US$2 trillion at the end of 2018, helping to drive growth across the region. Despite the economic slowdown, Asia Pacific is expected to achieve a 5-year compound annual growth rate (CAGR) of 10%, compared to a far more lackluster performance in other regions*. China will be at the forefront of that growth.

Against that backdrop, FleishmanHillard's second China-focused Future of Asset Management Survey picks up on a number of themes it examined last year, along with some new ones. This year we take a closer look at the impact of COVID-19, geopolitics, digital distribution and environmental, social and governance (ESG) investing.

Where the research revisits areas covered last year, the findings show consistency in the responses. One such response is the value that local investors in China put on transparency in process and fees. Given the competitive nature of the market, the need to be able to articulate unique investment strategies and other points of differentiation is paramount. Effective communications are essential.

We believe the consistency in the findings gives them greater veracity. We hope that you find them informative.

*Sources: CNBC: China's fund flows are in a "very, very good place": Broadridge (July 17, 2020) and Broadridge Financial Solutions: Gaining a distribution edge in APAC – the world's fastest growing region (June 2020)

Section 1

INDUSTRY LANDSCAPE

ASIA

The full economic and financial impact of COVID-19 remains to be seen and likewise the ramifications of the geopolitics being played out at present, but it's clear that Asia Pacific faces a dramatic slowdown. This will affect the asset management sector just as it will most other business sectors. Yet the region is resilient and expected to see growth in the coming years, outperforming most other regions.

China will lead the way thanks largely to hugely untapped savings for investment, combined with digitalization to drive distribution, advisory services and market access. As well, foreign asset managers now have greater access to the China market making a wider range of products available to investors.

Incremental reforms by the China Securities Regulatory Commission (CSRC) have yielded significant advances for the sector in the past year, notably the introduction of more market-opening measures. The outcome is more foreign fund managers in China, assets under management at record highs, and huge fund inflows.

The first quarter of 2020 saw fund inflows to China of about US$135 billion excluding money market funds, the highest since 2007. The rest of Asia Pacific saw outflows of US$40 billion, while the US and Europe had outflows of US$400 billion*.

INFLOWS AND SECTOR GROWTH DESPITE PANDEMIC

The inflows took place despite COVID-19, major geopolitical issues, economic slowdown and escalating trade tensions between China and the United States. These tensions include a recent call for US pension funds and other organizations to divest from Chinese companies.

However, it comes at a time of greater investor access to China A shares through MSCI indices, Stock Connect and Bond Connect. Alongside, changes in the tax regime for overseas income that took effect this year are resulting in a growing volume of tax payments from Chinese nationals abroad.

The CSRC's underlying strategy is clear: encourage and promote foreign investment, ensure legal protection for investors, and create greater competition in the domestic mutual fund market.

*Sources: CNBC: China's fund flows are in a "very, very good place": Broadridge (July 17, 2020) and Broadridge Financial Solutions: Gaining a distribution edge in APAC – the world's fastest growing region (June 2020)

CHINA

WFOES AND SCRAPPING OF FOREIGN OWNERSHIP LIMITS

On January 1, 2020, China's new rules on foreign investment took effect, allowing local subsidiaries of foreign asset managers to launch mutual funds. The subsidiaries, wholly foreign-owned enterprises (WFOEs), had previously only been allowed to sell private funds to wealthy individuals and family offices. Under the new rules, foreign firms with a registered capital of at least CNY400 million can apply for mutual fund licenses.

In April, the CSRC scrapped the 49% foreign ownership limit for asset management joint ventures, effectively allowing foreign ownership of up to 100%. The wholly-owned mutual fund licenses awarded by the CSRC permit foreign asset managers to access China's retail investor market.

At the time of writing, one US-headquartered asset manager is poised to take full ownership of a local mutual fund business with the purchase of China International Fund Management (CIFM). As well, another overseas asset manager in August 2020 received an official go-ahead from the CSRC to establish a WFOE in order to enter the retail fund market*.

QDLP RESTARTS

In March, Beijing resumed granting Qualified Domestic Limited Partnership (QDLP) licences to foreign asset managers. The QDLP scheme was launched back in 2013 but had been on hold for more than a year. By April 2020, there were 40 QDLP funds offered by 28 managers – both foreign owned and joint ventures – according to figures from the State Administration of Foreign Exchange (SAFE).

QDLPs allow qualified foreign asset managers to raise renminbi-denominated sums from qualified individual and institutional investors in mainland China for overseas investments within allocated quotas. Since the launch, China has granted US$5 billion in quotas, according to SAFE.

*Sources: Fund Selector Asia: https://fundselectorasia.com/blackrock-receives-approval-for-china-retail-fund-firm/ (August 31, 2020)

BYE-BYE QFII AND RQFII QUOTAS

In May, the CSRC removed the quotas for two prominent inbound investment schemes – Qualified Foreign Institutional Investor (QFII) and Renminbi Qualified Foreign Institutional Investors (RQFII) – to help open up China's financial market to foreign investors. The move was first announced in late 2019.

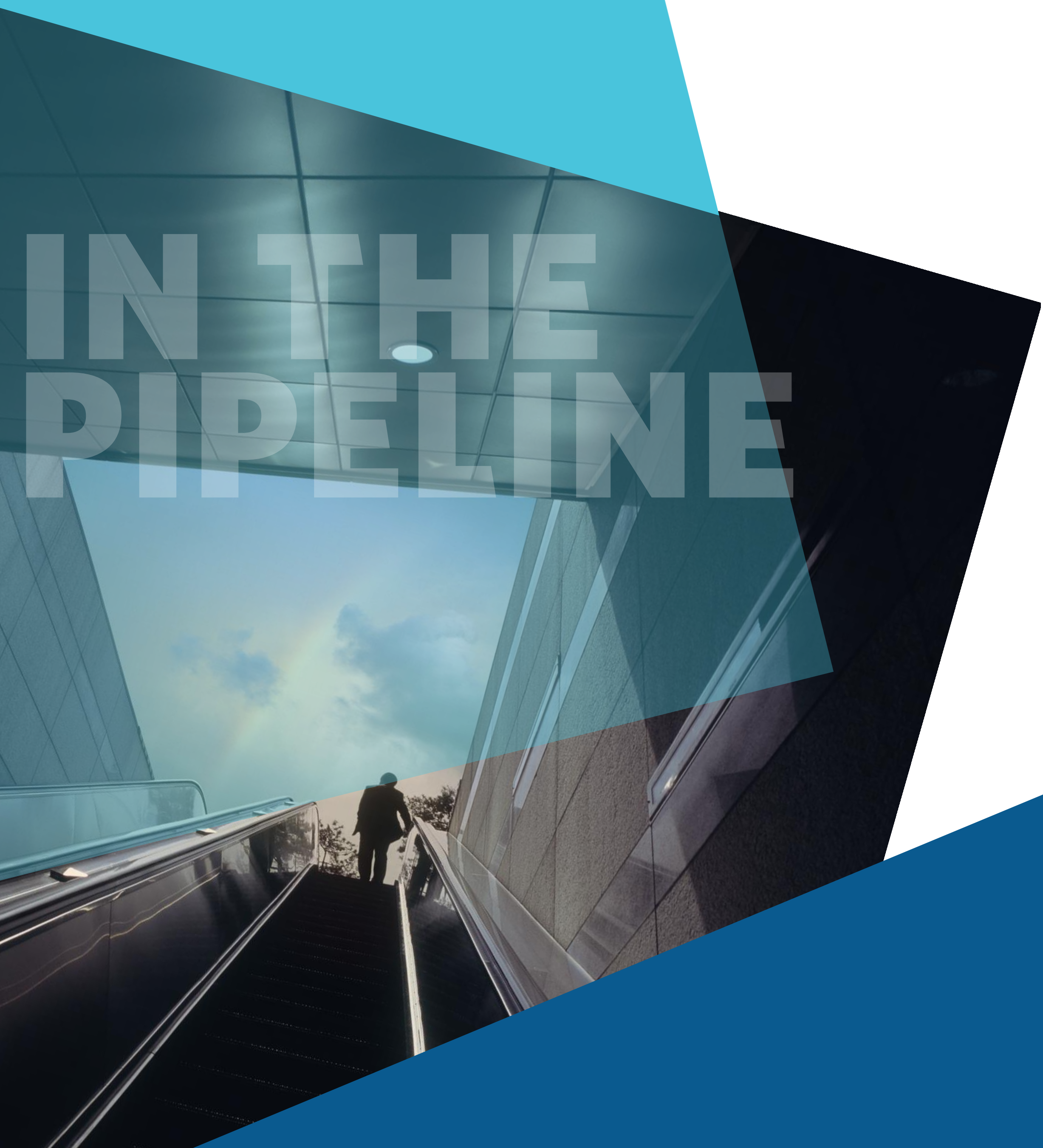
Both schemes had been on the wane since the launch of the Stock Connect schemes, China Interbank Bond Market and the Mutual Recognition of Funds between Hong Kong and mainland China.

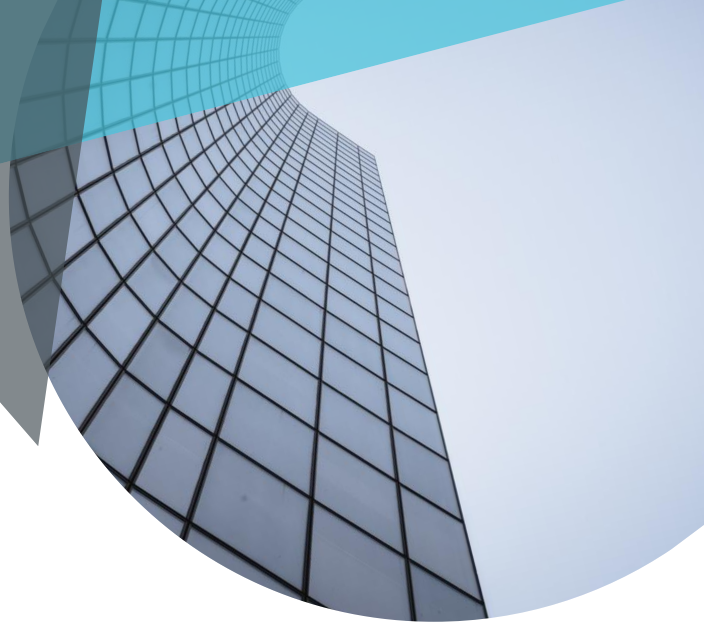
In the future, rather than applying for quota from SAFE, asset managers' local entities just need to register with SAFE.

> *"Despite the COVID-19 pandemic and geopolitical issues, the asset management industry in China continued to grow healthily thanks to the ongoing relaxation of market access rules for overseas asset managers."*

Section 2

IN THE PIPELINE





WEALTH MANAGEMENT CONNECT

Late July saw regulators in Guangzhou and Shenzhen outline specific investment schemes and products for asset managers to develop as part of a wealth management connect pilot linking Hong Kong, Macau and Guangdong province – the Greater Bay Wealth Management Connect scheme.

New rules for the scheme allow foreign commercial banks to set up investment firms and wealth management firms without ownership limits. The rules also permit overseas subsidiaries of mainland Chinese securities and mutual fund firms to provide investment advisory services for their parent companies investing overseas via the QFII scheme.

Wealth Management Connect will create growth opportunities for the sector, while investors will benefit from a wider range of choices, including more risk diversification options for which there's appetite in the current volatile environment.

INSURANCE CONNECT

Meanwhile, an insurance connect scheme is being developed between Hong Kong and mainland China with a view for a launch possibly by the year-end. This will form part of the financial integration of the Greater Bay Area (GBA). The introduction of the scheme will be gradual. Initially, Hong Kong insurers will just focus on post-sales services such as handling claims, changing policyholders' information and processing payment of premiums.

The Insurance Connect scheme is aligned with the wider GBA development and integration, which includes the Wealth Management Connect initiative to allow the sale of investment products via banks in 11 cities in the GBA*.

ETF CONNECT

The on-off plans for an exchange-traded fund (ETF) connect are back on again – discussions had been on hold since 2018. On August 28, 2020, the Securities and Futures Commission (SFC) authorized two ETFs to be listed on the Stock Exchange of Hong Kong (SEHK) under a scheme which will facilitate cross-listing of ETFs between markets in Hong Kong and the Mainland. The two ETFs will each invest in an ETF approved by the CSRC and currently listed on the Shenzhen Stock Exchange*. The scheme is a testament to the deepening of cooperation between the Mainland and Hong Kong capital markets and will provide Hong Kong and Mainland China investors with more investment opportunities and product choices through access to each other's market.

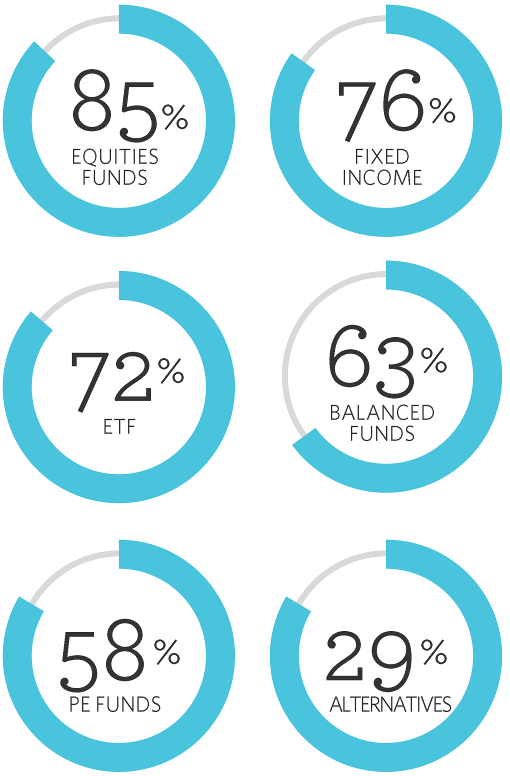
*Source: SCMP: Insurance connect will be the next big step for Greater Bay Area (July 24, 2020), The Securities and Futures Commission: https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=20PR80

Section 3
SURVEY

SUMMARY

TRUE Global Intelligence, FleishmanHillard's in-house research practice, conducted an online survey among 250 Chinese investment, finance and banking professionals between July 20 and July 27, 2020.

All respondents to the survey have traded or invested in at least one of the following:



The survey looked at the experience and attitudes of local Chinese professional investors towards foreign-based asset management companies, compared to local ones. The survey also sought to get a better understanding of how the various foreign options – QDLPs, WFOEs, JVs and potentially foreign-owned retail funds – are perceived in the local market.

Survey highlights:

- Asset management performance and credibility are critically important for Chinese investors making their investment decisions.
- Global brands offering a unique trading strategy, sophisticated risk management and transparency in communications would differentiate from the local alternatives, for which local Chinese investors would pay a higher fee.
- There are signs of a growing preference for local asset managers, suggesting demand for highly localized foreign brands with local expertise.
- Digital and, in particular, mobile distribution channels for thought leadership and products are critically important.
- COVID-19 has had relatively little impact, yet the vast majority have changed their approach to risk as a result of the US-China trade tensions.
- There is appetite for greater risk, new/innovative products and ESG capabilities.

Section 4

THE RESULTS

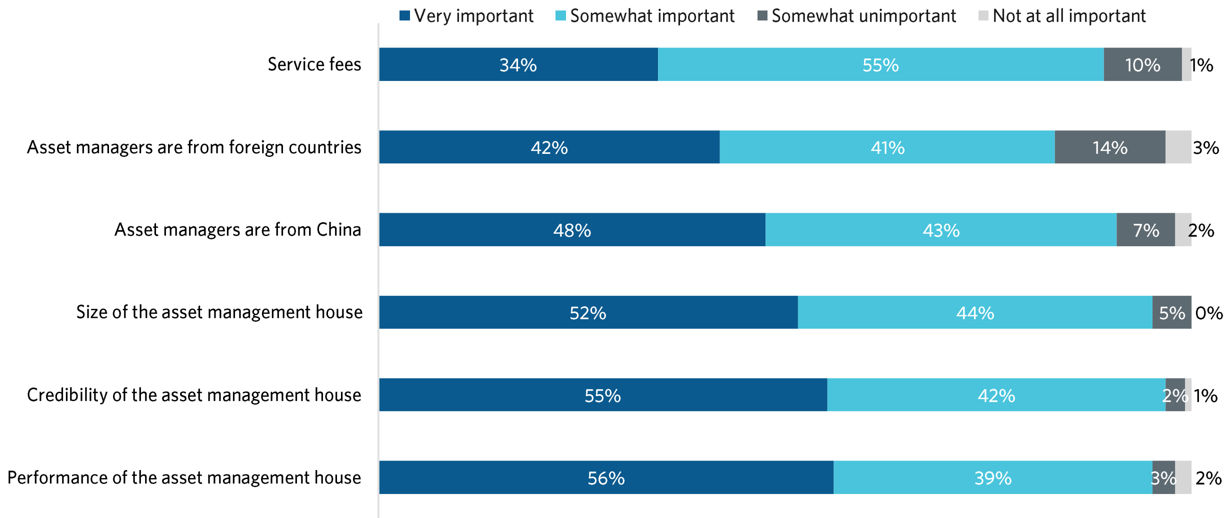
DETAILS

Asset management performance and credibility remain the most important factors when selecting a fund manager, but there is a fall in the number who consider it very important – performance factors dropped to 56% from 64% last year and credibility fell to 55% from 74%. However, the net importance (combining "very" or "somewhat" important) shows little change from last year.

Notable too is the discernible rise in number of investors looking for asset managers from China. Almost half (48%) of the respondents said that having an asset manager from China is a key factor when making their investment decisions, up from one-third last year. Local investors' preference for foreign fund managers rose also, but less significantly, from 32% last year to 42% this year.

One other observation from the findings, particularly on the question of foreign versus local asset managers, is that there is less grey area – fewer respondents sat on the fence. Opinions on this look to be a little more polarized than last year.

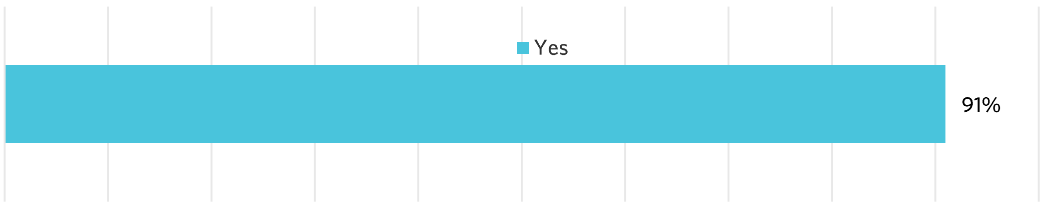
HOW IMPORTANT ARE EACH OF THE FOLLOWING WHEN CHOOSING AN ASSET MANAGER?



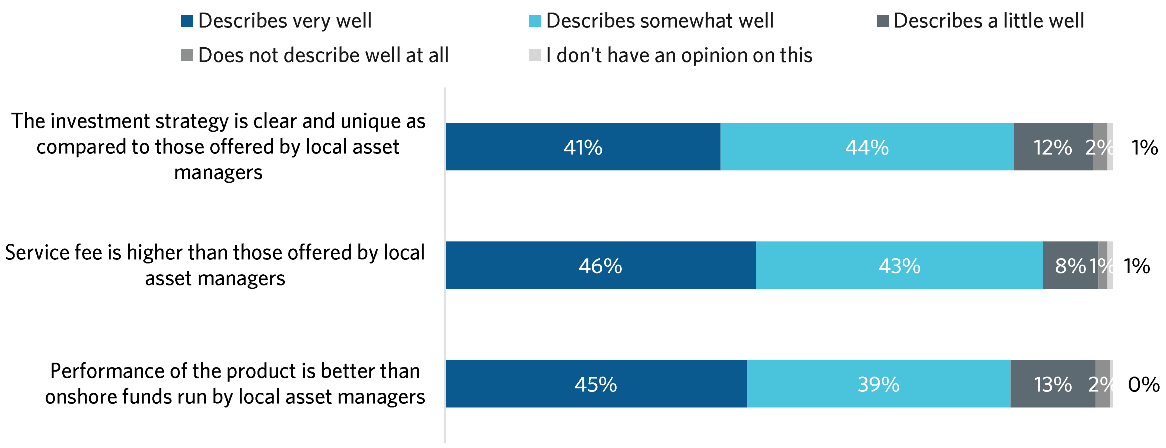
INFORMATION SOURCES

QDLP remains a popular investment vehicle with their overall performance considered better. The QDLP products are thought to offer more distinctive and original investment strategies. Just over 90% of the investors had invested in QDLPs run by overseas asset managers. Most of them experienced higher service fees, but they found that acceptable.

HAVE YOU INVESTED IN ANY QUALIFIED DOMESTIC LIMITED PARTNERSHIP (QDLP) FUNDS RUN BY OVERSEAS ASSET MANAGERS IN CHINA?

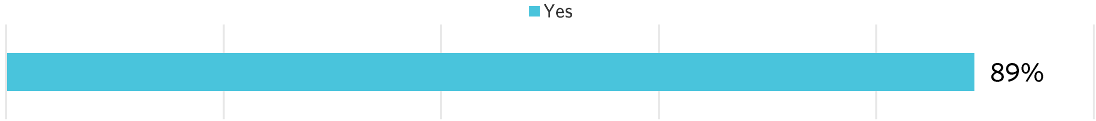


HOW WOULD YOU DESCRIBE YOUR EXPERIENCE INVESTING IN QDLP?

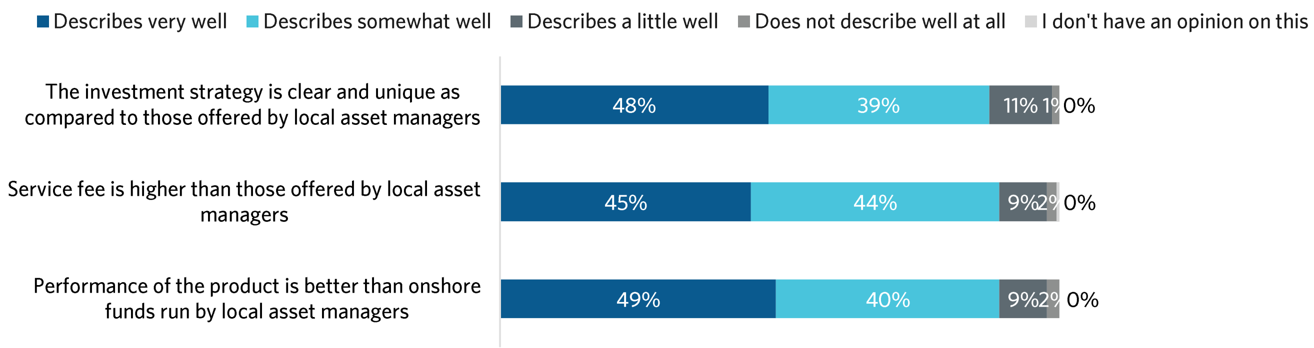


Almost nine out of ten (89%) of the investors had purchased fund products from overseas asset management houses that have a WFOE, down a fraction from last year (91%) when the survey looked purely at private fund products sold by WFOEs. Feedback on WFOE asset management funds was similar to QDLP. The performance is good and investment strategy is unique, while the fees are on high side but very manageable. Appetite for WFOE products clearly remains very strong, reflecting the confidence many Chinese investors have in overseas fund managers.

HAVE YOU PURCHASED PRIVATE FUND PRODUCTS FROM OVERSEAS ASSET MANAGEMENT HOUSES THAT HAVE A WHOLLY FOREIGN-OWNED ENTERPRISE (WFOE) IN CHINA?

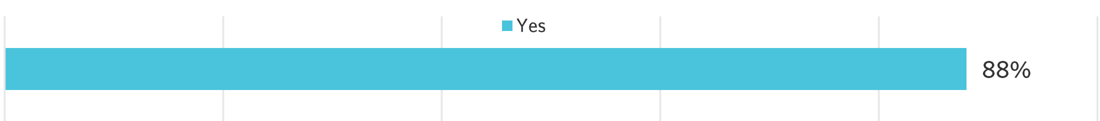


HOW WOULD YOU DESCRIBE YOUR EXPERIENCE INVESTING IN PRODUCTS OFFERED BY WFOES?

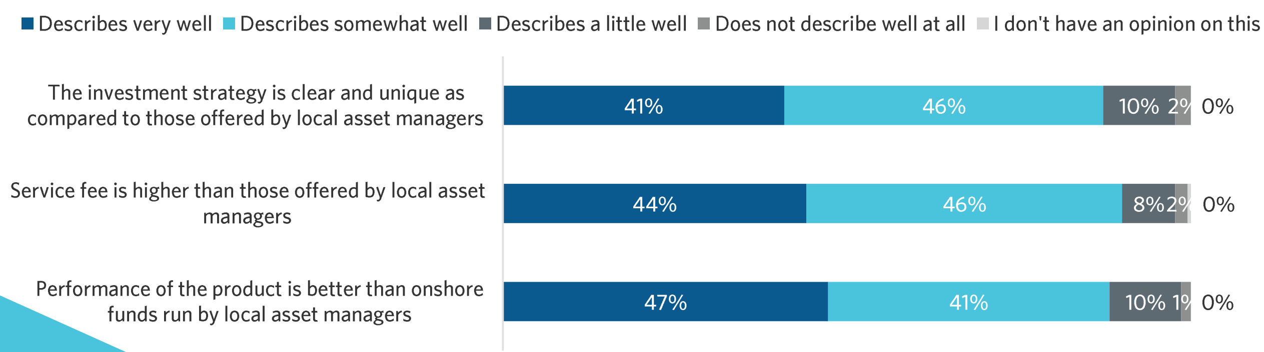


Investors surveyed with experience purchasing products from overseas asset managers with a local JV dropped slightly to 88% from 93% last year. Those who invested in products from JVs said the performance is better than onshore funds run by local asset managers.

HAVE YOU PURCHASED PRODUCTS FROM OVERSEAS ASSET MANAGERS WITH A LOCAL JOINT VENTURE (JV)?



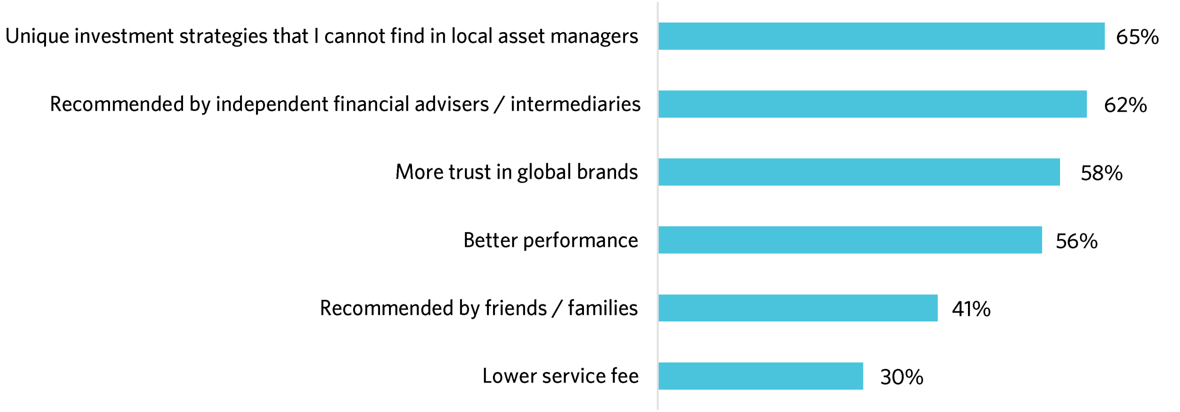
HOW WOULD YOU DESCRIBE YOUR EXPERIENCE INVESTING IN PRODUCTS OFFERED BY JOINT VENTURE?



Unique investment strategy and recommendations from independent financial advisers / intermediaries were the two main factors considered in investment decisions. Last year, better performance and trust in global brands were cited as the two main criteria. These remain important, but clearly investors are looking for something a bit different and presumably the independent financial advisers are opening their eyes to new opportunities.

Mainland China investors are not too concerned about the service fees, but if they are paying more, they want to get something that is different and effective that they cannot get at a lower rate locally. This presents opportunities for overseas asset management firms that can offer different types of products, such as ones focusing on alternatives or that are ESG compliant.

IF YOU HAVE PURCHASED PRODUCTS FROM WFOE/JV ASSET MANAGERS BEFORE, WHY DID YOU CHOOSE TO PURCHASE FROM THEM INSTEAD OF PURELY LOCAL MARKET PLAYERS?



Nine out of ten investors would be interested in onshore retail funds potentially offered by overseas asset managers. The prospect of global brands with their own strategies fused with mainland China expertise for the China market is clearly compelling for local investors.

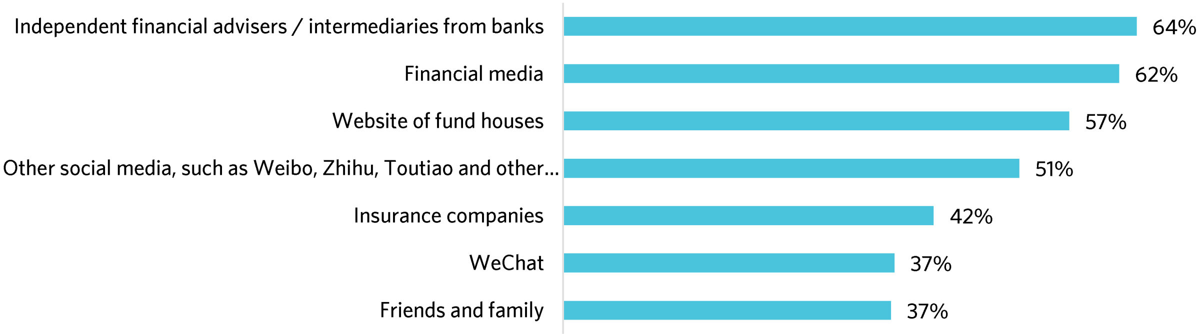
A FEW OVERSEAS ASSET MANAGERS ARE APPLYING TO LAUNCH ONSHORE RETAIL FUNDS. HOW INTERESTED WOULD BE IN THIS KIND OF PRODUCT?

INFORMATION SOURCES

The two most important information channels for mainland China investors are independent financial advisers or intermediaries from banks, along with finance media. That said, usage of these has declined since last year.

The value of financial media, however, remains strong and up slightly from a year ago. The fact that reliance on social media channels has declined suggests that investors seek more reliable and better-sourced financial information, which is good news for financial news services.

THROUGH WHICH OF THE FOLLOWING CHANNELS DO YOU RECEIVE INFORMATION ON FUNDS AND INVESTMENT PRODUCTS?



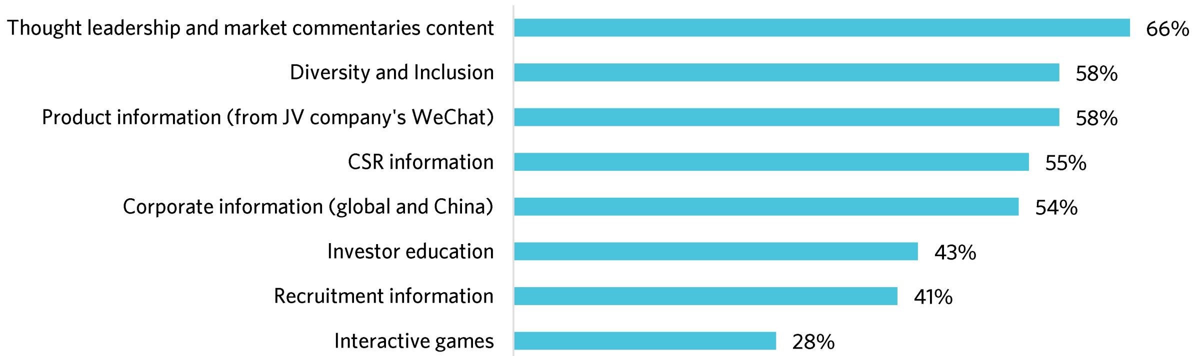
More than one-third of the investors surveyed use WeChat for information on funds and investment products, with two-thirds of those mostly seeking thought leadership and market commentary. Interestingly, just over half of investors (55%) use it to find CSR information reflecting a growing awareness and appetite for asset managers' purpose and shared values.

With more than a billion users, WeChat cannot be ignored by overseas asset management firms particularly in China where it provides a mobile ecosystem that includes financial services and e-commerce. On WeChat and other platforms, mobile is becoming a major distribution channel in China for wealth management products.

Recent executive orders from the US will likely have put some asset managers on edge. While the impact is still unclear at this stage, one thing that is clear is the importance of WeChat for companies operating in China.

37% ***Of investors use WeChat for information on funds and investment products***

WHAT TYPE OF INFORMATION DO YOU TYPICALLY LOOK FOR FROM THE WECHAT CHANNELS OF ASSET MANAGERS?

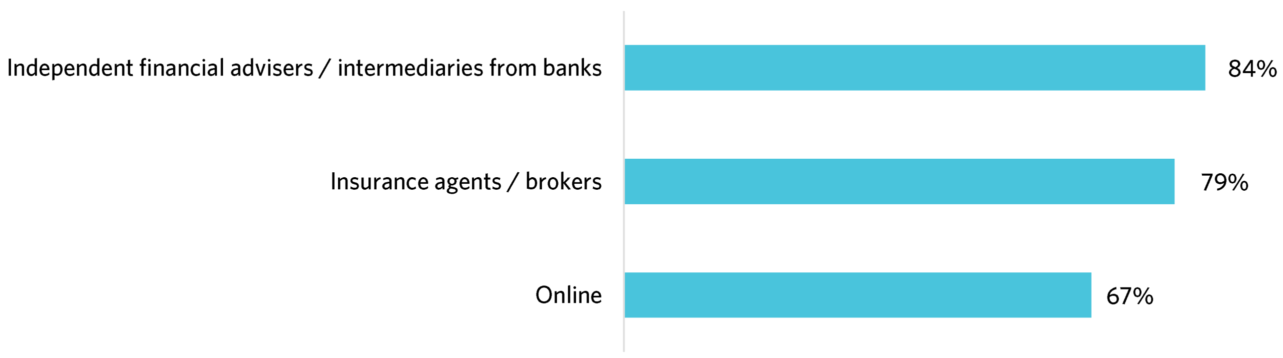


Investors primarily want to see performance reporting and investor education, but roadshows are also valued. They seek transparency in communications.

WHAT TYPE OF INFORMATION DO YOU SEEK FROM FUNDS AND INVESTMENT PRODUCTS?

Very similar to last year, independent financial advisers or intermediates from banks are most valued for fund patronage. However, insurance agents and brokers have leapfrogged online channels. Clearly, face-to-face interaction still matters a lot despite the growing use of online channels.

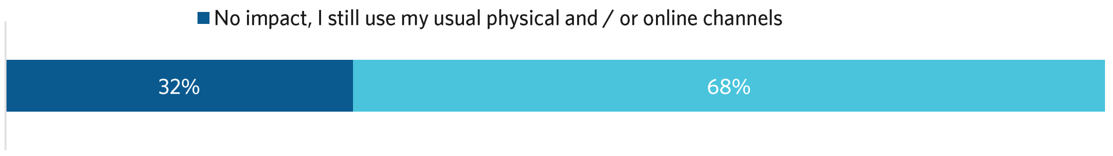
WHAT ARE YOUR SOURCES OF FUND PATRONAGE?



COVID-19

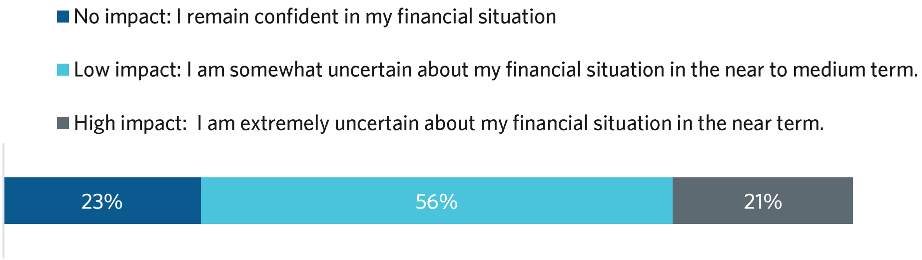
While face-to-face interactions are key, the COVID-19 pandemic has sparked the use of more online channels for patronage or access to fund information in China, with 68% switching to online. This is likely here to stay, emphasizing the need for a digital – and mobile – strategy. This includes rethinking the way information is presented and disseminated.

HOW AS THE COVID-19 PANDEMIC AFFECTED YOU IN THE PATRONAGE OR ACCESS OF INFORMATION FOR FUND PRODUCTS IN CHINA?



Four out of five investors said COVID-19 has affected their financial situation, but just one in five (21%) said they are extremely uncertain about their financial situation in the near term. Overall, the impact looks to have been relatively moderate – for 56% it is described as low. It suggests that plenty of market opportunities continue to exist despite the disruption.

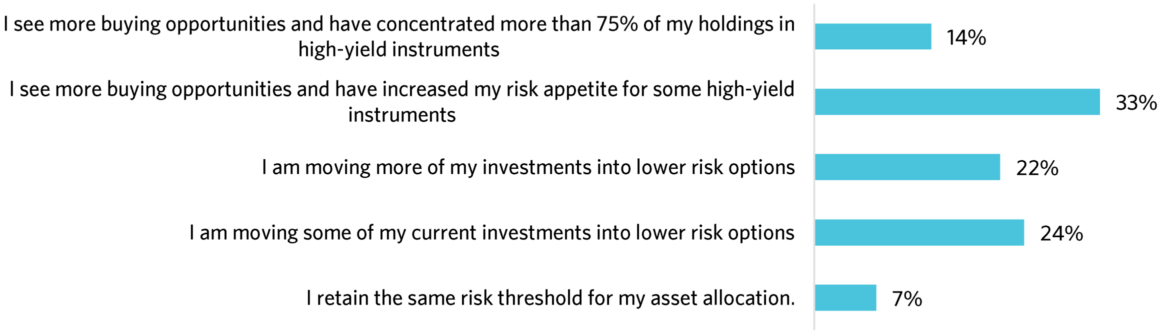
HOW HAS THE COVID-19 PANDEMIC IMPACTED YOUR LEVEL OF CONFIDENCE IN YOUR PERSONAL FINANCIAL SITUATION IN THE NEXT ONE-YEAR TIMEFRAME?



GEOPOLITICS

For any foreign company operating in or looking to enter China, the current geopolitical tensions are hard to ignore. Yet for investors, the survey shows that one-third of surveyed investors increased their asset allocation risk appetite as a result of the tensions. Interestingly, more than 90% said they had altered their approach because of the trade tensions.

HOW HAVE THE ONGOING US-CHINA TRADE TENSIONS AFFECTED YOUR INVESTMENT OUTLOOK AND RISK APPETITE IN TERMS OF YOUR ASSET ALLOCATION?



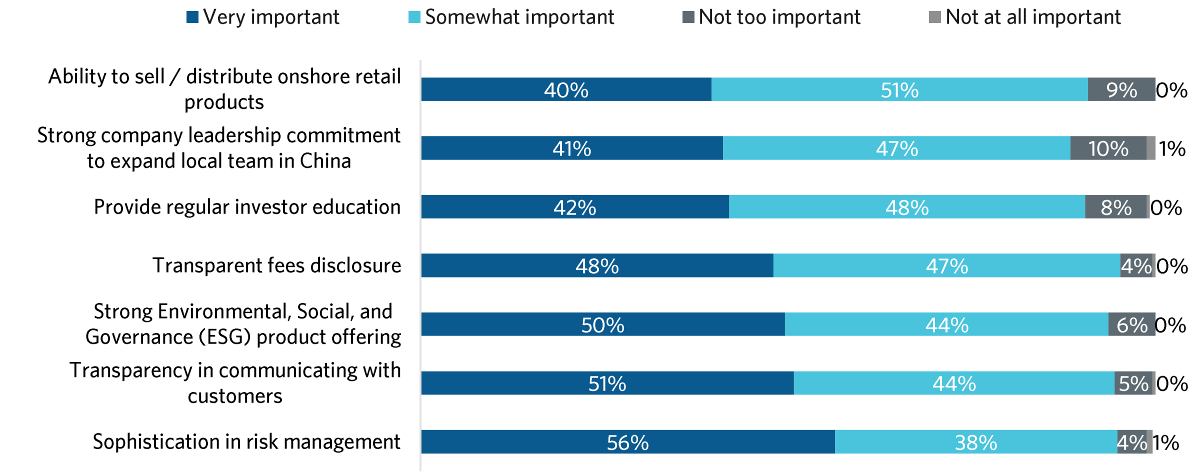
APPEALING TRAITS

The most sought-after traits in overseas asset management houses operating in China are little changed from last year. A common thread throughout the survey is investor focus on the need for genuine added value from the asset manager, in form of unique investment strategy or, as we see here, sophistication in risk management. Transparency in communicating with customers is also considered a very important quality.

For foreign asset managers, that is good news: Chinese investors are very similar to those elsewhere in the world in their attitudes and expectations. Transparency, sophisticated risk management, strong leadership and a commitment to China are very important.

Investment capabilities, such as ESG expertise, factor into their portfolios in order to generate alpha. Chinese asset managers have made progress in expanding their ESG research capabilities, while regulation has encouraged disclosure and onshore Chinese companies have increasingly been included in global benchmarks.

FOR EACH OF THE FOLLOWING DESCRIPTIONS, PLEASE INDICATE HOW IMPORTANT IT IS FOR OVERSEAS ASSET MANAGEMENT HOUSES OPERATING IN CHINA TO HAVE THE FOLLOWING.



Concluding Thoughts

The year to date has been a remarkable one of pandemic, disruption and genuine change. Looking ahead, we would like to highlight four trends that will significantly influence China's asset management industry creating opportunities for foreign firms over the coming year.

RAPID GROWTH AMID MARKET VOLATILITY

China's asset management sector will continue to grow and is expected to drive growth in the region over the next few years. With Asia Pacific expected to see 10% CAGR through 2024, China as the driver is set to be well out in front.

Yet that growth is likely to be tempered at times by highly volatile market conditions as the pandemic and trade tensions persist. The cost of economic recovery and restoring public finances make tax increases, currency volatility and higher interest rates possibilities for the coming months.

Yet with the economic fallout there will be opportunities. Chinese investors' greater appetite for risk offers more scope for higher yield bonds, alternatives, private equity, foreign-currency assets and other higher risk instruments. This combination gives foreign firms the chance to differentiate themselves and offer innovative products that will appeal to local investors.

UNDERSTANDING THE LANDSCAPE

Lifting China's barriers to entry for foreign asset managers has been incremental, but the pandemic may well inject greater speed into the process. For asset managers, the challenge will be to select the right business model for market entry – WFOE, JV or QDLP. The risks and costs vary significantly.

Understanding the local lay of the land is critical. A few overseas asset managers have already applied for retail fund licences, and the first one received the official go-ahead from Chinese authorities to commence the build-out of its onshore fund management unit in late August 2020. They all had no choice but to operate JVs before applying for WFOE licenses. Some of them have or are planning to buy out their JVs in China.

The benefits of a JV include local knowledge and distribution, helping to grow brand awareness and business. But unwinding a JV can be complex and expensive.

Such is the competition, asset managers entering the China market need to build brand awareness. At the same time, simply having a deep understanding of the local market is not enough; they need to demonstrate that understanding too. Central to this are transparency of operations and effective communications that can reach target audiences.

COMMUNICATIONS

One consequence of the pandemic is the move to digital by retail investors. Region-wide, it is here to stay. Face-to-face interactions may continue, but at much reduced levels and often using video. In a sense, owing to its lack of legacy systems, China is ahead of the curve on digitalization. There is wider acceptance of it and deep market penetration.

The move to online via mobile means that asset managers need to think of the best ways to reach investors through online tools, both for managing investments and for access to market information. While the importance of user experience on their own platforms cannot be overstated, they will need to build a presence wherever the retail investors are located. They will need to find a way into the mobile ecosystems their target investors inhabit.

Channels such as WeChat and Weibo will play a key part for foreign asset managers, regardless of what's said about these platforms in other countries.

OFFERING EXPERTISE, ADDING VALUE

A strong brand and record of performance are very important factors when making investment decisions, but investors in China want more than that if they are to pay higher fees. The survey findings show they accept higher fees but want to see discernible added value in return. A distinctive investment strategy or sophisticated risk management are examples of what they seek.

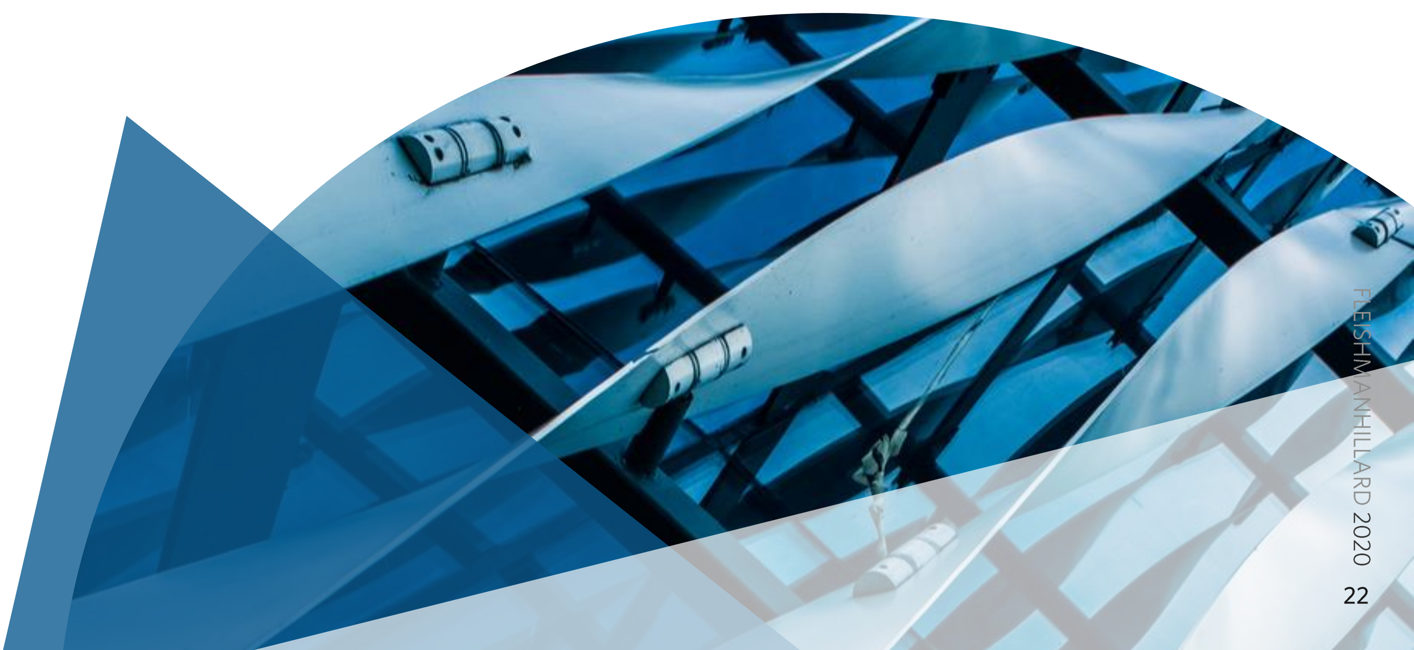
Equally important is the need for transparency in communicating with customers. Amid signs of a growing preference for local asset managers, foreign firms will need the ability to communicate the merits of being a foreign asset manager, along with the unique qualities that they bring to the mix.

The survey shows growing appetite for ESG capabilities. As in other parts of the world, the COVID-19 experience has put a greater focus on climate change, lifestyle, community and governance in China. Globally, ESG funds attracted net inflows of US$71 billion between April and June this year, lifting AUM in ESG products to a new high of just over US$1 trillion*. China is seeing growth in this sector too.

China is already established as one of the world's leading issuers of green bonds. But the move to ESG compliant investing has gone well beyond that, with various companies developing their own ESG investment frameworks.

Foreign expertise on ESG investing and managing compliance with globally accepted guidelines presents an opportunity to offer a service that's distinctive and adds value. It is aligned with government policy and offers excellent thought leadership opportunities.

*Source: Financial Times, ESG funds attract record inflows during crisis (10 August 2020)



Be Bold, Stay True

The COVID-19 pandemic and ongoing geopolitical issues present a complex asset management industry in China. FleishmanHillard's global communications team is well-equipped to advise global and local asset managers, industry players and professional firms in areas of corporate communications, media relations, public affairs and reputation management.

> ***"FleishmanHillard is your go-to-consultancy to manage your communications and reputation in China."***

Understanding the industry landscape and having a well-thought out communications strategy continue to be important for overseas asset managers to flourish and attract mainland investors. As you embark on your journey in China's capital market, please count on us to be trusted and effective teammates!

Disclaimer

This report by FleishmanHillard is a collection of publicly available information, announcements, analysis and media reports. The report aims to provide an overview of key trends affecting the Chinese asset management industry. FleishmanHillard makes no representations as to the accuracy, completeness, correctness, suitability, or validity of any information stated, and will not be liable for any errors. All information is provided on an as-is basis, based on the latest updates from credible publications and publicly available sources. The statements and analysis expressed herein are an assessment of such materials, and do not reflect the views or position of FleishmanHillard or FleishmanHillard and their employees.

Appendix

Sources:

CNBC: China's fund flows are in a "very, very good place": Broadridge (July 17, 2020)
Broadridge Financial Solutions: Gaining a distribution edge in APAC – the world's fastest growing region (June 2020)
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