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Asset Management in China 2020

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Summary

China's asset management industry is changing rapidly, following a series of reforms and market liberalization policies. In the post-"super guidance" era, more players are deepening their participation in asset management, such as banks and foreign firms. Managers must be aware of the intense competition lying ahead, arm themselves with niche capabilities, and explore new business models to stand out from their peers.

Key Points

- The evolving retail market landscape should push managers to reinforce their strengths in equity investment, asset allocation and non-traditional strategies, and upgrade their collaboration with banks and third-party online platforms.
- Managers should position themselves well and develop strategies quickly to gain first-mover advantages in the less-crowded passive space, which is gaining attention due to institutions' evolving demand, government support and recovery in sentiment after the stock market fall. Managers also need to tackle declining margins with fee pressure.
- Foreign managers will continue to expand into the public funds market as it further opens, and source new opportunities in other market sectors, such as banks' wealth management products.
- The country's third-pillar pension scheme is also set to expand, but managers' patience and consistent performances are key to break into the huge market.

After a series of tightened regulations in the past two years, particularly following the "super guidance", the industry is set for diversification. Following the weak stock market and strict controls on shadow banks in 2018, the recovery in market sentiments and moderate monetary policy in 2019 have given managers time to stabilize their shrinking institutional businesses and raise retail awareness.

Against this backdrop, assets under management (AUM) of China's mutual funds and ETFs continued their growth momentum in the first nine months of 2019 to reach RMB14.3 trillion (US$2.0 trillion), after a 13.7% surge to RMB13.7 trillion in 2018. Passive products have gained popularity since 2018, spurred by market movements during the year, attracting both retail and institutional investors who saw the falling domestic stock markets as providing opportunities to seize undervalued shares.

Fund managers' discretionary assets stayed stable at RMB6-6.5 trillion in 2018 and first nine months of 2019, despite the halving of their subsidiaries' assets to below RMB5 trillion from RMB10.5 trillion in 2016, due to regulatory curbs on shadow banking activities.

Meanwhile, other players are expanding into the retail market. Banks are now allowed to set up wealth management subsidiaries, which could be the biggest rivals to fund managers' public market business. More recently, the removal of foreign ownership limits on fund management companies has been brought forward to 1 April 2020.

To help managers map out their strategic plans in the constantly changing market, Cerulli highlights five key trends in 2019.

Key Trend 1: Evolving retail market landscape to push managers to upgrade

The "super guidance" of 2018 was aimed at eliminating regulatory loopholes, controlling risks, and creating a level playing field. However, the standardized definitions of public and private asset management products seemed to provide opportunities for various asset managers to reach out to mass-retail investors by launching public products, which so far are mostly mutual funds.

With new rules released after the "super guidance", other players venturing into the retail market may have certain advantages, as they are supervised by different regulators. For example, banks are allowed to set up wealth management (WM) subsidiaries, which could be the rivals to fund managers' public market business.

In late 2018, the China Banking and Insurance Regulatory Commission Banks (CBIRC) released two sets of rules on banks' WM businesses operating within the banks or via new WM subsidiaries.

Previously, banks' wealth management products (WMPs) required a minimum investment of RMB50,000, much higher than that of mutual funds. With standalone subsidiaries now allowed, banks' WMPs will be able to reach mass-retail investors and have more flexibility in distribution and investment. Their public WMPs can invest into non-standard debts and be distributed through channels other than banks, in-person signatures are not required for first-time purchases, and structured WMPs are allowed. In contrast, mutual funds, overseen by the China Securities Regulatory Commission (CSRC), have the same investment thresholds, but are restricted to standard assets. The tax advantages of investing in mutual funds may Lure institutional investors but not retail investors, who are usually not sensitive to fees.

As of end-2019, ten banks have started operating WM subsidiaries, including China Construction Bank (CCB), Industrial and Commercial Bank of China (ICBC), Bank of China (BOC) and Bank of Communications (BOCOM), with the first launched by CCB in June 2019. Five more have obtained approval from regulators, and around 20 are awaiting approval.

Even though these subsidiaries are still new, and banks need time to figure out the suitable business models for the new segments, competition for retail customers will come soon, and subsidiaries may eventually move into the institutional sector as they mature. Some bank-backed FMCs have already started to feel the tension, as banks, the biggest institutional investors of FMCs, are likely to give preference to their fully owned subsidiaries.

Nevertheless, challenges and opportunities co-exist. Fund managers will have to identify new opportunities, build their niches, and expand their distribution networks.

Enriching investment strategy offerings

By reinforcing their strengths in equity investment and asset allocation and developing more non-traditional strategies, fund managers should be able to stand firm amid the evolving landscape and even find new collaboration opportunities with banks.

Banks have expertise in cash and fixed-income management. Most investors buy banks' WMPs for capital protection, and stable but higher returns than deposits. Even though banks emphasize on non-guaranteed terms now, individual investors may still believe banks are giving implicit guarantees. As such, fund managers may see some outflows from their low-risk products, but will continue to have expertise in equities, at least for some time in the future, before banks' subsidiaries gain multi-asset management capabilities.

Meanwhile, due to their lack of experience in managing products under the net asset value (NAV) model, banks may want to seek managers' help in product design and asset allocation. Non-traditional strategies, such as enhanced index and smart beta, may also interest them, as they prefer stable products with some excess returns.

Successful collaboration on product design will not only raise managers' brand reputation in the retail market, but also increase their chances of winning banks' outsourcing assets.

Upgrade collaboration with third-party online distributors

Except several leading players, which have established online platforms that have captured sizeable numbers of investors, most fund managers find it hard to access massretail investors directly. As banks' subsidiaries could crowd out mutual funds distribution through banks and eventually other channels, managers will need to rethink their ways of working with the fast-growing third-party online channel, besides strengthening their own platforms.

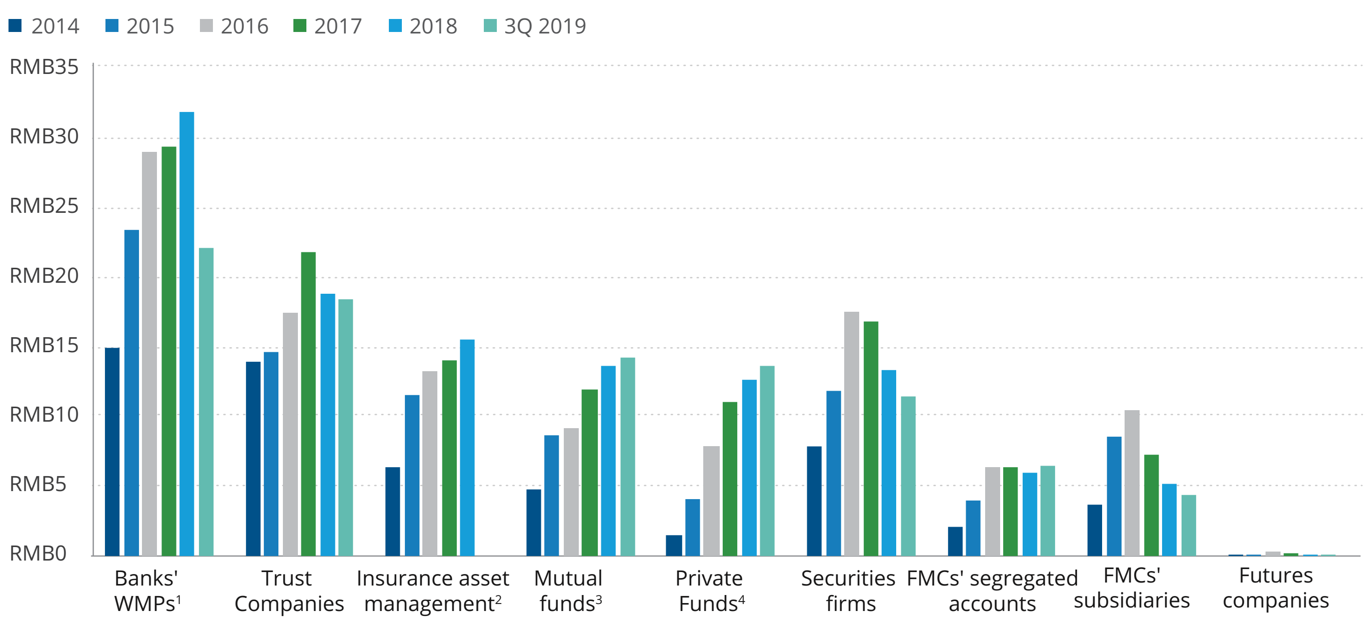
According to a survey conducted by the Asset Management Association of China (AMAC) in 2018, 41.6% of individual mutual fund investors in China were below 30 years old, and 80.8% were below 45 years old. A total of 87.4% of all individual fund investors usually invest online. This includes online transactions via all types of distributors' platforms.

However, more than 40% of respondents said they would increase transactions with non-bank online platforms in the following year.

Snapshot of China's Asset Management Industry, 2014–3Q 2019 (RMB Trillions)

Sources: Asset Management Association of China, Cerulli Associates

Analyst Note: [1]Guaranteed WMPs are excluded from 2019 onwards. 2Q2019 data of non-guaranteed WMPs is showed here. 3Q2019 data is not available. [2]2019 data is not available. [3]Include all ETFs. [4]Funded assets only.



Tiantian Fund, a fund distribution platform under Eastmoney, has been generating more fund sales than Agriculture Bank of China, one of the largest five banks in China, for the past four years. The sales volume of Alibababacked Ant Financial, another leading platform, may be about the same level, managers told Cerulli. Tencent's Licaitong joined the game late, but grew rapidly thanks to the huge user base, at nearly 1.1 billion, of Tencent's Wechat.

With these giant platforms becoming mainstream fund distributors in recent years, many managers have established special departments or teams to deal with them. The relationship between managers and platforms are also moving from simple fund selection and sales to more customized, institutionalized and technolog ydriven collaboration. Platforms quickly learn about their end-investors' behaviors and interests, leveraging on their advanced big data capabilities, and give feedback to managers for better product design.

At the same time, some platforms, such as Ant Financial, Tiantian Fund and JD Finance, are opening their platforms to managers, by allowing them to set up their own wealth accounts to interact with end investors. This increases managers' influence on the huge base of retail investors. Managers must beef up their strategies catering to these investors, who are young and usually lured by simplicity, convenience, and investment returns.

Key Trend 2: Product diversification led by passive boom

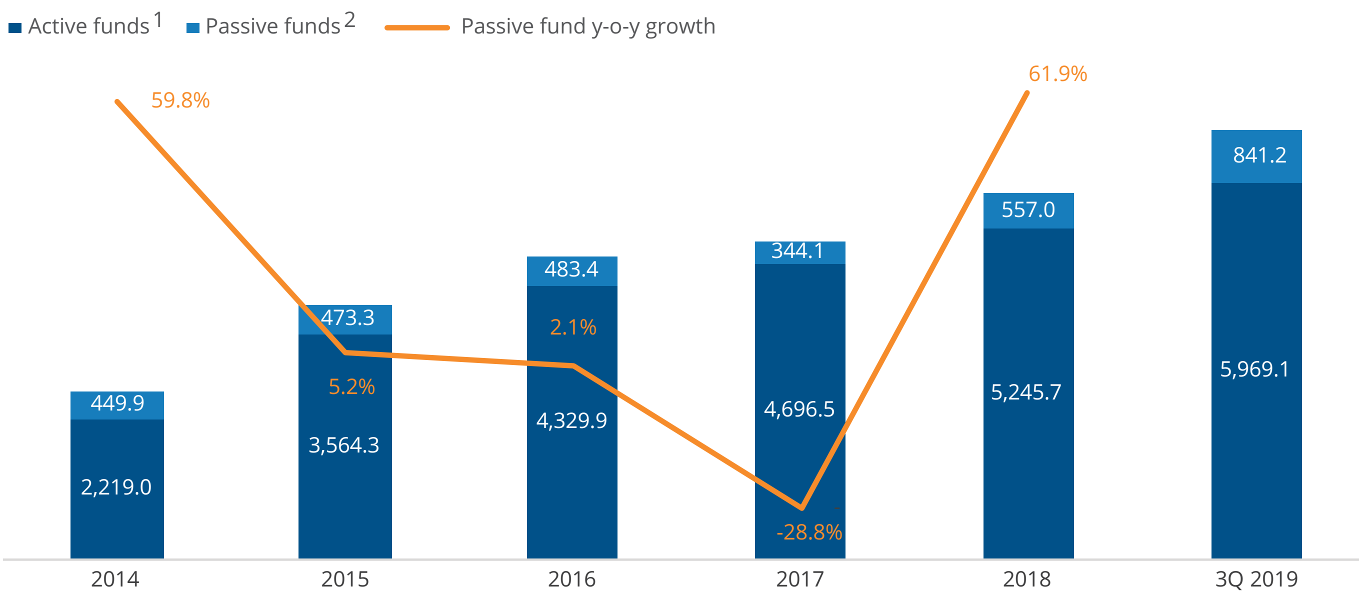
China's fund market has been overcrowded in recent years, with nearly 6,000 funds offered in the market. With guaranteed funds and structured funds being cleaned up by the regulator, managers now have a greater desire for product differentiation. The underserved passive segment has drawn the most attention since 2018, given institutions' evolving demand, government support and recovery in sentiment after the stock market fall.

Passive fund assets increased 144.5% to surpass RMB800 billion (US$118.1 billion), during the 21 months from January 2018 to September 2019. Exchange-traded funds (ETFs), excluding money market ETFs, accounted for more than half of total passive assets.

Fund Assets Under Management By Investment Style, 2014–3Q 2019 (RMB Trillions)

Source: Morningstar Direct, Cerulli Associates

Analyst Note: [1]Excludes money market funds. [2]Includes index funds, index-listed open-end funds and non-money-market ETFs.



Bond index funds and ETFs are the most popular passive funds, favoured especially by institutions. The initial public offering (IPO) volume of bond index funds in 2018 was around 10 times that in 2017, and the IPO volume of such funds in the first four months of 2019 was 2.5 times that of 2018. ETFs attracted record-high inflows in 2018, at RMB189.6 billion, mostly contributed by inflows to equity ETFs in late 2018. Managers are still keen to launch such products—70 ETFs were waiting for regulator's approval as of June 6, 2019, more than quadruple the level two years ago.

ETF managers also lead in product innovation. Besides the traditional broad-based index ETFs, many products with new themes and strategies have emerged in recent years, including state-owned enterprise (SOE) reform, regional integration, smart beta, Environmental, social, and governance (ESG), gold futures and Japan market. Cerulli also expects more innovative ETFs in these areas as well as further industry segmentation, new technology or economy, bond index, commodity and overseas exposure.

In addition to passive funds, some new actively management fund types gained approval in 2019. These include money market funds managed using NAV and tech-themed funds that focus on the newly established science and technology bourse. Funds of funds (FoFs) and pension target funds (PTFs) are also in managers' product pipelines, despite their lukewarm fund-raising results.

Key Trend 3: Declining margins with fee pressure

The average net profit margins for China's largest 20 mutual fund managers (based on available data) dropped to 26.1% in 2018 from 29.5% a year ago. This is bigger than the slight fall in 2017 from 30.8% in 2016. Average profit yield—which measures how much managers earn in basis points (bps) for each dollar they manage (only based on mutual fund AUM)—was about 21.5 bps in 2018, 3.5 bps and 6.7 bps lower than that in 2017 and 2016, respectively.

Net Profits Of Largest 20 Mutual Fund Managers By Assets Under Management In China, 2018

Source: Shareholders' annual reports, Cerulli Associates

Analyst Note: AUM excludes ETFs and includes open-end funds and closed-end funds. [1]Bank-backed fund management company. [2]Net profit estimated from shareholders' investment income. [3]Includes net profit earned from mutual funds, segregated accounts and subsidiaries business. [4]Measures how much managers earn in basis points for neach mutual fund renminbi they manage

Rank (AUM)	Fund Company	2018		
		Mutual Fund AUM (RMB billions)	Net Profit (RMB millions)[3]	Profit Yield (bps)[4]
1	Tianhong Asset Management	1342.1	3,069	22.9
2	CCB Principal Asset Management[1]	629.6	1,146	18.2
3	E Fund Management	612.2	1,365	22.3
4	ICBC Credit Suisse Asset Management[1]	591.3	1,496	25.3
5	Bosera Asset Management	531.1	903	17.0
6	China Southern Fund Management	500.8	839	16.8
7	GF Fund Management	454.0	451	9.9
8	China Universal Asset Management	435.1	1,029	23.7
9	Harvest Fund Management[2]	397.4	1,170	29.4
10	Bank of China Investment Management[1]	388.1	973	25.1
11	China Merchants Fund Management[1]	369.8	894	24.2
12	China Asset Management	357.4	1,140	31.9
13	Penghua Fund Management	306.0	456	14.9
14	Ping An Fund Management	274.4	N/A	N/A
15	HuaAn Fund Management	238.8	421	17.6
16	Yinhua Fund Management	234.2	397	17.0
17	ABC-CA Fund Management[1]	231.8	439	18.9
18	Guotai Asset Management	192.2	N/A	N/A
19	Lombarda China Fund Management	184.9	239	12.9
20	AEGON-Industrial Fund Management	183.3	726	39.6

Fee pressure could be one of the main contributors of the lower margin. Similar to the trend globally, Chinese fund managers have started to offer products with more competitive pricing. With the boom in passive funds, both active and passive funds are under growing pressure to lower fees. Bond index funds are examples of this trend. Their weighted average management fees stood at only 21 bps in 2018, compared to 26 bps in 2017.

Ping An Fund Management was the one of first to lower its management and custodian fees. The company triggered a price war in the ETF market when it launched its Growth Enterprise Board (ChiNext) ETF in February 2019, charging a management fee of only 0.15% and a custodian fee of just 0.05%–20bps in total. It also joined others in reducing the charges of active management funds, by cutting the management fee of a mixed fund from 1.5% to 0.6%, and custodian fee from 0.25% to 0.1%, in July 2019.

Many leading managers have also adopted the same charges for selected funds—mostly non-flagship products though, to attract institutional investors—who are more sensitive to fees than retail investors.

With large firms hit by sliding fees and margins, smaller firms are facing a much tougher environment than ever before. They will need innovative products and supportive distributors, which are also hard to tap in a market which barely has advisory-based fee model. In the meantime, they will have to garner more resources from existing shareholders, or look for new stronger shareholders, to sustain the business.

Private funds not immune

Like mutual funds, private securities funds (PSFs), or private funds investing mostly in publicly traded securities, have suffered from fee pressures amid heavy competition.The “2-20” fee structure—2% management fee and 20% performance fee—was once the most common fee models in China’s PSF industry. However, as of July 2019, more than 60% of PSFs charged management fee less than or equal to 1%.

Some managers have implemented a phased performance fee structure to get higher cuts on higher returns, so as to make up for the reduced income from the lower management fee. However, such fee structures need popular strategies and managers’ strong confidence in their investment capabilities.

Key Trend 4: Foreign managers expand onshore as market further opens

The liberalization of China’s financial market has been accelerating. In the policy outcome of 10th UK-China Economic and Financial Dialogue held in June 2019, China said it welcomes eligible foreign managers to convert their wholly foreign-owned enterprises (WFOEs)–which are registered as private securities fund managers (PSFMs) with AMAC–into public fund management companies, while allowing for continuity of business.

Just two weeks later, at the 2019 Summer Davos Forum, Premier Li Keqiang announced that China would deepen the liberalization of its financial and service industries, and bring forward the removal of foreign ownership limits on the securities, futures and insurance industries to 2020 from 2021. Soon after, the State Council Financial Stability and Development Committee officially released 11 measures to further open up China’s financial industry. Three months later, the removal of foreign ownership limits on fund companies was brought forward further to 1 April 2020.

Besides being allowed to enter the retail market earlier and in a smoother way, foreign managers can expect more regulatory developments benefiting their PSFM business. For example, the quota constraints on Qualified Foreign Institutional Investor (QFII)/ RMB Qualified Foreign Institutional Investor (RQFII) will be removed soon, and eligible managers for the two schemes may be allowed to invest in onshore PSFs, and appoint their affiliated WFOE PSFMs as investment advisors. WFOE PSFMs may also invest in a broader range of securities via the Mainland-Hong Kong Stock Connect. So far, they are requested to raise fund onshore and invest onshore.

Measures To Further Open Up China's Financial Industry, July 2019

Source: Financial Stability and Development Committee of the State Council, Cerulli Associates

Securities, fund, future companies	• Removal of foreign ownership limits on securities, fund and futures firms brought forward to 2020 from 2021. (On fund firms was brought forward further to 1 Apr 2020 in October 2019.) • Foreign institutions encouraged to establish wholly owned money brokerage companies, or invest in these companies.
Bond	• Foreign institutions are allowed to rate all types of bonds in the inter-bank bond market and the exchange bond market, when conducting credit rating business in China. • Foreign institutions are allowed to obtain Class A lead underwriter licenses for the inter-bank bond market. • Investment of foreign institutional investors in the inter-bank bond market further facilitated.
Wealth Management	• Foreign financial institutions are encouraged to participate in banks' wealth management subsidiaries. • Foreign asset management institutions are allowed to establish wealth management companies controlled by foreign parties with subsidiaries of Chinese banks or insurance companies.
Insurance	• Removal of foreign ownership limits on life insurance companies brought forward to 2020 from 2021. • Foreign institutions are allowed to hold more than 25% shares of insurance asset management companies. • 30-year operation request for foreign insurance companies to enter the China market removed.
Pension	• Foreign financial institutions are allowed to invest in pension management companies.

At the time of writing, almost all leading global asset managers have shown interest or have already ventured into China. Cerulli believes most of them have long-term plans and are expanding into China at their own pace, but with a definite and shorter time frame as to when they are allowed to have fully controlled public fund companies, they will be in a better position to win resources and support from their global headquarters.

Meanwhile, the opening of the public market has not stopped foreign managers from growing their PSFM business, which is crucial to establish their own brand names onshore. As of October 30, 2019, a total of 22 foreign managers have registered as PSFMs in China, of which 19 have launched a total of 58 PSFs. Moreover, the three managers who have not yet launched any products were all registered this year.

Challenges always exist when entering a new market. The lack of public information makes the private fund industry less transparent and more relationship-based. While it is difficult for both domestic and foreign managers to establish themselves in the market, foreigners could face more difficulties in dealing with local distributors, which may have stringent criteria.

New opportunities emerge in other market sectors

Some other sectors that have had less foreign participation are welcoming global managers amid the accelerated market liberalization. Foreign managers are now able to set up joint ventures (JVs) with banks' wealth management subsidiaries, asset management arms of their insurance JVs, and JV pension management firms.

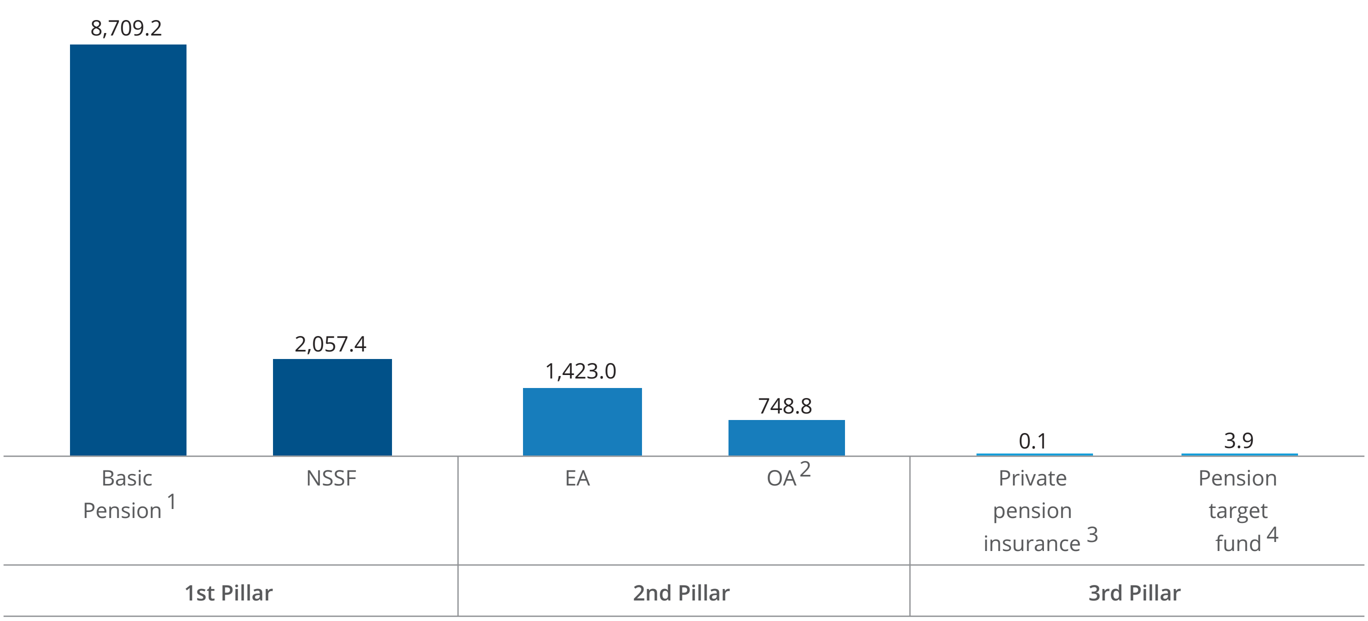
Among these sectors, banks' WMPs is the most attractive market for foreign managers, with a size much bigger than that of mutual funds. Amundi received the first approval to set up a majority-owned wealth management entity with subsidiary of Bank of China in December 2019. Meanwhile, BlackRock is reportedly partnering with Temasek to form a similar entity with China Construction Bank, while JP Morgan has formed a strategic partnership with China Merchants Bank instead of a JV.

In general, there are more opportunities for foreign managers to expand their presence in China. They will need to assess the business potential in each sector and select a suitable plan based on their expertise, and act fast if they want to partner with big banks.

Chinese Retirement Assets, 2018 (RMB Billions)

Source: Ministry of Human Resources and Social Security, National Council of Social Security Fund, China Merchants Securities, Cerulli Associates

Analyst Note: Data as of December 2018. [1]Excludes portion outsourced to NSSF. [2]Estimated by China Merchants Securities. [3]Premium income. [4]IPO volume. Pension target funds are not included in tax benefit scheme at the time of writing.



Key Trend 5: Third-pillar pension scheme set to expand

China's pension system has been relying heavily on the first pillar, which includes the basic pension scheme and the National Social Security Fund (NSSF). In response to the aging population, the government introduced enterprise annuities (EA) in 2004 and occupational annuities (OA) in 2016 to supplement statutory pensions. However, due to its voluntary nature, participants in the EA scheme are largely government-linked corporations. As were intended to be compulsory, but are only applicable to civil servants.

The third-pillar pension pilot scheme was launched in May 2018. The pilot scheme includes only pension insurance products with tax benefits, but fund managers can launch PTFs in the FoF structure to cater to investors' retirement demand.

However, insurers and managers did not see the flows they expected to go into their pension products. According to local news reports, as of March 2019, only about 40,000 investors had volunteered to purchase the tax-deferred pension insurance products, and total premium income stood at only RMB100 million. PTFs, which are yet to be included in tax benefit schemes, raised only RMB13.8 billion in total as of May 2019—38 out of 74 approved PTFs have been launched, and none of them raised more than RMB1 billion, except those of Minsheng Royal Fund and Bank of Communications Schroder Fund Management. There are many reasons for this, including low income, few tax incentives, tedious processes to claim tax deductions, less attractive product returns (2.5% to 3.5% for pension insurance products, similar to returns of MMFs, which are more liquid), volatile stock market, and the lack of distribution models, which encourage long-term holding of investments. It is also disappointing that no new products were included into the tax benefit scheme in May 2019, one year after the start of pilot programmes, as the regulator had planned.

However, Cerulli believes that managers are more patient now, after going through the product launch and marketing process. They are well aware of the fact that tax incentives alone cannot bring about the success of such products. Investors' awareness on retirement planning and regular investments are also key elements. These need a stable capital market, stable-return products, and continued investor education. "Chinese investors may need 20 years or one generation to build the habit of investing regularly for their retirement," a manager told Cerulli.

One positive outcome is that regulators have been actively seeking managers' feedback on scheme design and learning from other countries on how to encourage people to invest for retirement. According to the Ministry of Human Resources and Social Security's news release in June 2019, the authorities are working on an integrated design for third-pillar pensions. They are considering adopting an account system, establishing a unified information management service platform, and expanding the scheme scope to include banks' WMPs and funds Regulators may need some more time to decide on a country-wide scheme that can be implemented, but Cerulli believes it is only a matter of time for the tax benefit scheme to be expanded. What managers should do is to provide stable products amid China's volatile stock market, so that investors can see their assets accumulate in the next three to five years, and gradually build their awareness of investing in mutual funds for their retirement needs. Managers with patience and consistent performances should eventually be able to break into the huge market.

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