THE FUTURE OF ASSET MANAGEMENT IN CHINA

FLEISHMANHILLARD 2019

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Executive Summary

China may be the land of opportunity for many, but the past year has been tough going for local and global asset managers in the country. Across the region, firms saw a meager 5% increase in assets under management in 2018, according to a McKinsey study. This was largely due to their performance in China, along with slowing growth, trade tensions and geopolitical issues across the region.

But despite the less than rosy picture, China remains promising. The region's asset inflows totaled US$2 trillion last year and, of this, mainland China accounted for a remarkable 93%.

It's not just about promise. The path ahead in China offers plenty to excite. While foreign asset managers have been permitted to set up operations in China since the early 2010s, it is only since 2015 that China's regulators have become more forthcoming with licenses for investment management wholly foreign-owned enterprises (IM WFOEs).

The pace of liberalization has since accelerated, raising eyebrows among even the most jaded observers. The full opening of the investment management industry, up to and including the ability for foreign firms to sell funds directly to the massive domestic retail market, is set to be achieved by 2020. Go back just a couple of years and such a prospect would have been met by industry experts with substantial skepticism.

In this report, first, we give a view of the industry landscape for foreign managers in China. Second, we share findings and insights from a recent FleishmanHillard survey of professional investors in China, which covers local attitudes to global brands and their offerings, both in general and on topical areas such as environmental, social and governance (ESG). And third, we offer our thoughts on where all this change is likely to lead, drawing on research and conversations with industry participants.

Asset management is just one component of China's reform agenda, but it is an important one. In a period of increasing conflict on trade and beyond, we believe moving toward a world where fund flows enable Chinese and global investors to invest in global and Chinese assets alike will be a positive development because it will require all parties to work together. For that to happen and for everyone to benefit, the need for effective communication is essential.

In the current increasingly volatile times, well-orchestrated strategic communications and reputation management seem desperately needed.

Section 1

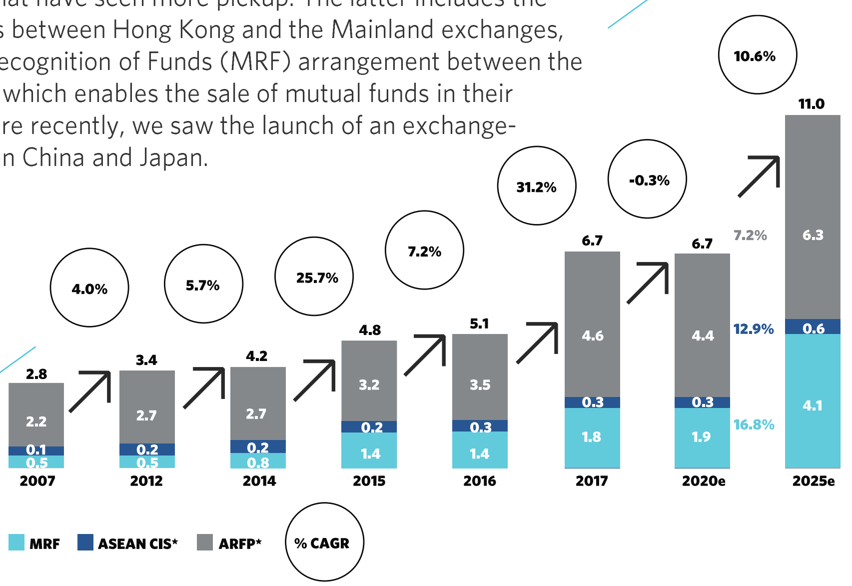
INDUSTRY LANDSCAPE

ASIA

For global asset management firms, Asia remains an attractive proposition. Profits in the region jumped 200% to about US$32 billion between 2007 and 2018, according to the Financial Times — four times faster than in the U.S. and Europe. And growth will continue at breakneck speed, with revenues set to hit US$122 billion by 2022, nearly doubling from 2017. Assets under management (AUM) in Asia are set to move in tandem, rising from US$15.1 trillion in 2017 to US$29.6 trillion in 2025, according to data from consulting firm PwC. That's a faster rate of growth than in any other region globally.

With Asia set to remain at the center of worldwide AUM growth, global firms face the challenge of managing both a sprint and a marathon at the same time. They are rushing to find an operating model that works in today's rapidly changing regulatory environment, while simultaneously preparing for the long-run. The latter preparations include giving their brand a chance to make a meaningful impact in, what are many cases, very young financial investment markets.

This growth in assets flowing into funds coincides with a period of rapid financial market integration in Asia. There have been regional initiatives, such as the Association of Southeast Asia Nations Collective Investment Scheme (ASEAN CIS) and Asia Region Funds Passport (ARFP), as well as country-specific ones that have seen more pickup. The latter includes the Stock Connect schemes between Hong Kong and the Mainland exchanges, as well as the Mutual Recognition of Funds (MRF) arrangement between the same two jurisdictions, which enables the sale of mutual funds in their respective markets. More recently, we saw the launch of an exchange-traded fund link between China and Japan.



Sources: ICI, Lipper, PwC Singapore, PwC AWM Research Centre analysis
Note: *Thailand is included in the ASEAN CIS and was removed from the ARFP to avoid double counting. When calculating AuM, we take into account all fund AuM for countries participating in said schemes. Sums may not add to 100% due to rounding

CHINA

The rising wealth of Asian investors and their growing appetite for diversification is nowhere more evident than in China. The banking and asset management sectors will oversee more than US$5 trillion by 2021, an estimate that rises to US$22 trillion if one includes insurers and trust companies, according to McKinsey data. This surge will further shift the global center of gravity toward China, which will be home to the world's second-largest asset management industry by 2023. It increases the urgency for global firms to set up shop and win over the attention of the Chinese investors — a challenge in a market inaccessible to them until not long ago.

Global asset managers have expanded their China offerings progressively. In the first phase, when no direct access to onshore investors was possible, their focus was on China's offshore wealth based in Hong Kong, typically held by entrepreneurs and management executives of Chinese firms with international operations. Their focus was also on sovereign wealth managed by sovereign wealth funds and the State Administration of Foreign Exchange, which manages the multitrillion dollar foreign currency reserves of the country. By McKinsey estimates, some US$1 trillion of externally managed assets are held through these sovereign channels.

The second phase gave global players more direct market access through tightly regulated schemes such as the Qualified Domestic Institutional Investor (QDII) program, launched in 2006, which involves a lengthy process to obtain a license and an investment quota from China's regulator. With this quota, managers in China can collaborate with onshore distributors to set up funds that allow local investors to tap global financial assets, including funds run by global firms. However, the slow pace of quota attribution means QDII is far from being a winner for these firms. The total allowance is still below US$100 billion, a tiny fraction of the massive domestic investment volume.

BY MCKINSEY ESTIMATES, SOME US$1 TRILLION OF TOTAL EXTERNALLY MANAGED ASSETS ARE HELD THROUGH THESE SOVEREIGN CHANNELS.

Another avenue was the Qualified Domestic Limited Partnership (QDLP) program. This structure was first introduced in 2012 and allows foreign investors to raise funds onshore in specific locales, such as Shanghai, for overseas investment in alternatives and typically private equity-type investments. The QDLP scheme's overall quota and accessibility remain tightly regulated by the Chinese authorities.

Other schemes include the Stock Connect between China and Hong Kong. This scheme allows all onshore investors to access the Hong Kong stock market directly, including retail investors, which limits the role of asset managers. Further, given the large number of Chinese firms that are listed in Hong Kong, Stock Connect has not offered Chinese investors much of a leap in terms of opportunity to diversify.

However, we have now fully entered the third and most promising phase of China's opening up — perhaps the final one. There are now more than 20 asset managers with onshore operations, whether through a WFOE or a joint venture with a local partner, according to data from consultancy Z-Ben Advisors.

PRIVATE FUNDS ARE A NECESSARY FIRST STEP ON THE ROAD TO WHAT WILL BE A LONG-TERM COMMITMENT TO THE MARKET.

For WFOEs, the first phase of operations has been marked by the slow and expensive buildup of resources and infrastructure, coupled with the regulatory limitation of only being able to target the private fund market for wealthy investors. Success has been limited, but for most firms in the category, including the likes of global giants Fidelity and BlackRock, this is a necessary step on the road to what will be a long-term commitment to the market.

For joint ventures, last year's announcement about the removal of ownership caps means that global firms now have a pathway to majority stakes, if not the outright acquisition of their China entities. Notable global names, such as J.P. Morgan, UBS and Nomura, have moved swiftly in that direction, winning bids to gain majority stakes and the ability to control their destinies in the Chinese market, while still being able to rely on the much-needed local expertise of their JV partners.

In an even more exciting move, the local regulator in China recently announced a plan to scrap foreign ownership limits in securities, futures and fund management firms in 2020. The limits will be abolished for futures firms on January 1, mutual fund managers on April 1, and securities companies on December 1 of next year. This step will give foreign players a chance to better tap the potential of the Chinese market.

In the long run, analysts see IM WFOEs as likely being the preferred channel; more so given the possibility, already discussed by the regulators, of allowing these corporate structures to obtain licenses to directly target the retail market starting in 2020. Should that prove to be the case, it would be a complete game-changer for global asset managers, at long last putting the entirety of China's huge market opportunity within reach.

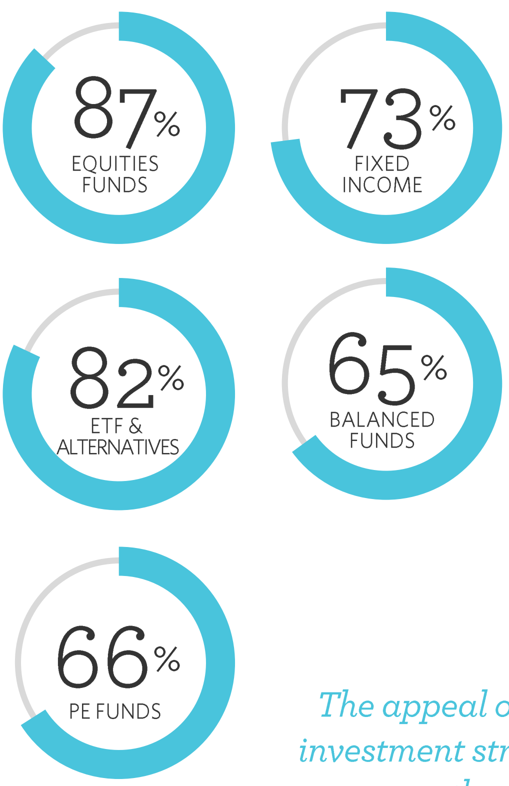
Section 2

OUR SURVEY

SUMMARY

TRUE Global Intelligence, FleishmanHillard's in-house research practice, fielded an online survey of 250 Chinese investors and investment professionals between August 10 and August 20, 2019.

All respondents to the survey self-identified as working in investment, finance or banking, and have traded or invested in at least one of the following asset classes:



The survey sought to understand investors' attitudes toward foreign investment firms, both those operating through WFOEs and joint ventures, and those using the alternative assets-focused QDLP scheme.

Survey highlights:

- Investors are focused first and foremost on the performance and credibility of the asset managers they select.
- Transparency and risk management sophistication are seen as most desirable attributes.
- A strong ESG offering is a plus for foreign asset managers targeting these investors.

The appeal of WFOEs and JVs lies in their unique investment strategies and performance, along with the greater trust placed in global brands.

Section 3
THE RESULTS

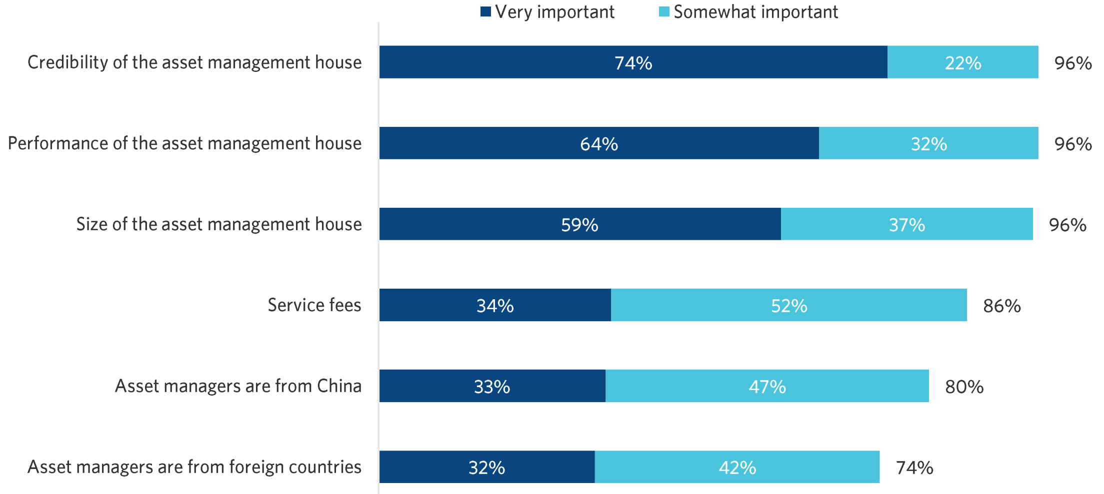
HIGHLIGHTS

The key finding of our survey counters the commonly held belief about the “home bias” of Chinese investors. The survey shows that home bias is not so strong. Interestingly, there is just a one percentage point gap between those believing that it is very important (33%) that the asset manager of choice should come from China, compared to 32% saying the same for foreign asset managers.

The insight we gain from this is that foreign fund managers are facing a market where investors are no longer focused on the nationality of origin of their investment services provider. Despite the liberalization of the market being still in its early days, at least for more sophisticated investors, there seems to be much more of a level playing field than typically thought.

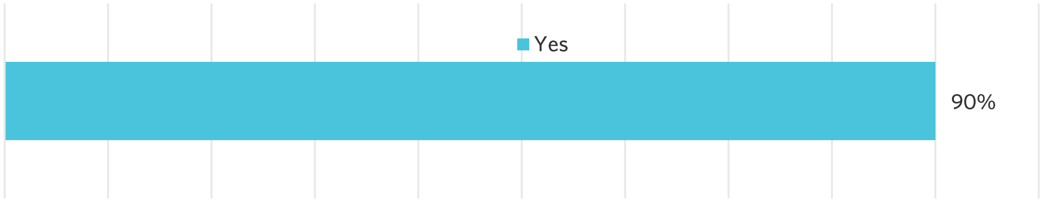
Overall, investors emphasize that credibility (74%) and performance (64%) are critical. While it is not surprising to find that Chinese investors, like those elsewhere in the world, see returns as a priority, the fact that they would pick a credible brand even more emphatically than one offering better returns is important. This is a key indicator of how important reputation is and will continue to be for firms operating in China. With most foreign players still little-known in the Mainland market, that reputation will need to be managed as part of a broader brand-building strategy.

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

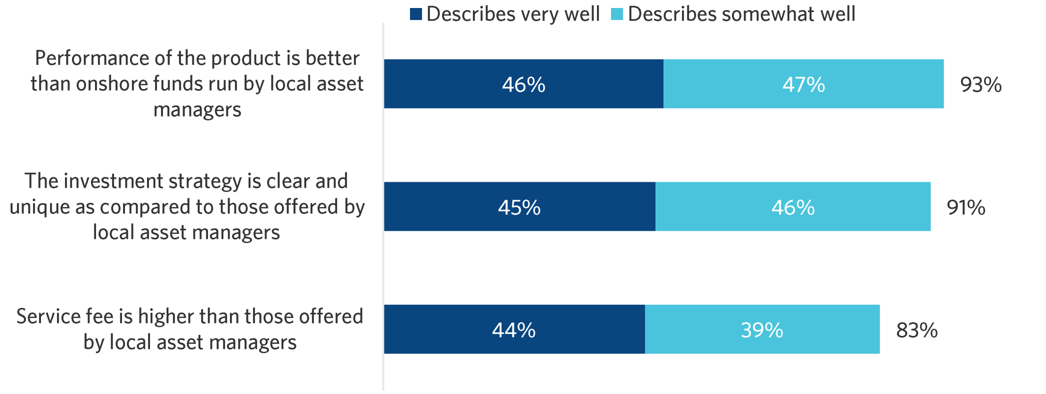


QDLP remains a higher-fee, somewhat higher return strategy than mainstream investments. Respondents see the uniqueness of the QDLP proposition, which could justify its popularity among professional investors.

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



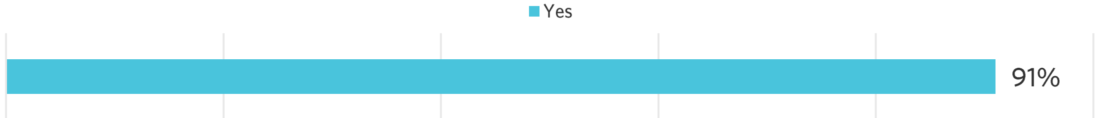
[IF YES:] HOW WELL DOES EACH OF THE FOLLOWING PHRASES DESCRIBE YOUR EXPERIENCE INVESTING IN QUALIFIED DOMESTIC LIMITED PARTNERSHIP (QDLP)?



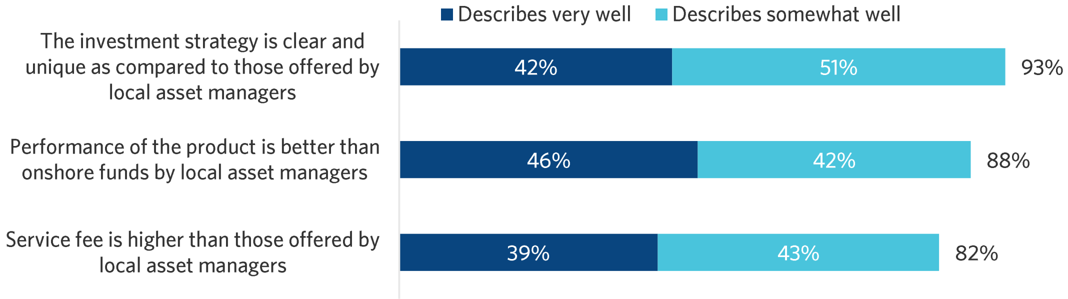
The fact that 91% of respondents said they are already getting exposure to WFOE private fund products, despite their recent introduction, is in itself a positive indicator of foreign managers' appeal in the competitive and crowded landscape.

Respondents noted that they liked these funds' strategies above all (93%), with a slightly smaller, but still dominant, proportion liking the performance, despite the fees being higher than comparable products by Chinese asset managers.

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

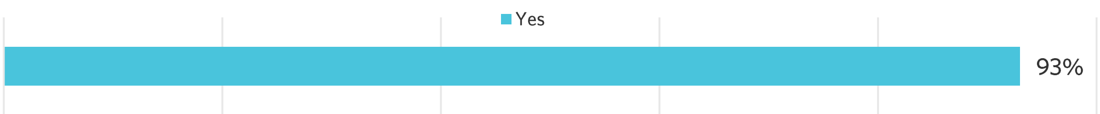


[IF YES:] HOW WELL DOES EACH OF THE FOLLOWING PHRASES DESCRIBE YOUR EXPERIENCE INVESTING IN WHOLLY FOREIGN-OWNED ENTERPRISE (WFOE)?

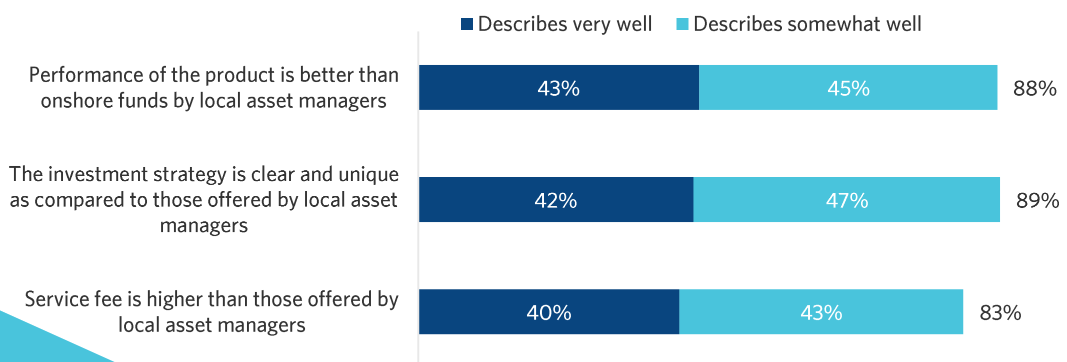


JV products enjoy a similar reputation to the above two categories, although respondents picked performance and a unique investment strategy as crucial in the same proportion.

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



[IF YES:] HOW WELL DOES EACH OF THE FOLLOWING PHRASES DESCRIBE YOUR EXPERIENCE INVESTING IN JOINT VENTURE (JV)?

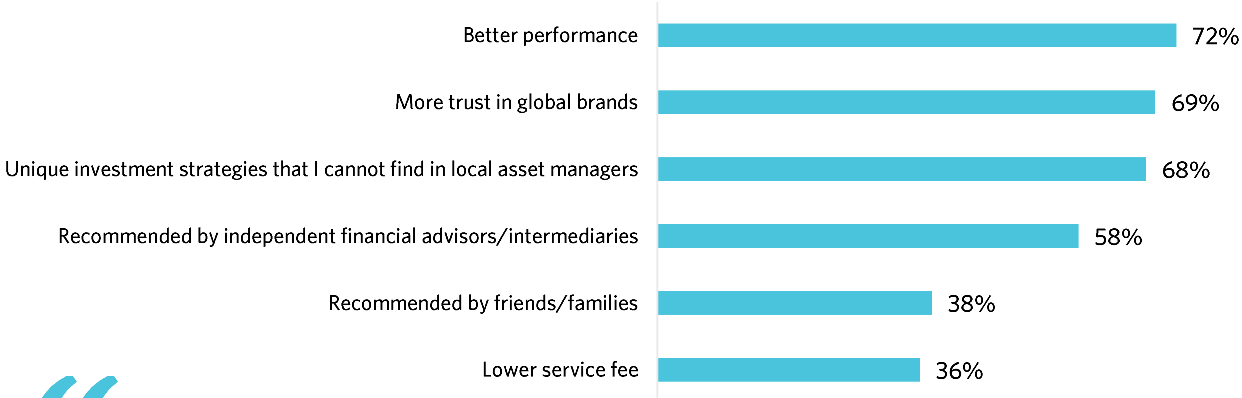


In one of the principal findings of our research, 69% chose WFOEs and JVs over local managers because they place higher trust in global brands, just slightly behind those seeking better performance.

Overall, performance, trust in global brands, and unique investment strategies were seen as having approximately same value as criteria when selecting WFOEs and JVs over purely local market players.

Conversely, recommendations through investors' networks and fees were seen as a much lower priority, pointing to the fact that these investors are very discerning and are likely to be conducting extensive due diligence before allocating their capital.

[IF PURCHASED WFOE OR JV] IF YOU HAVE PURCHASED PRODUCTS FROM WHOLLY FOREIGN-OWNED ENTERPRISE (WFOE)/JOINT VENTURE (JV) ASSET MANAGERS BEFORE, WHY DID YOU CHOOSE TO PURCHASE FROM THEM INSTEAD OF PURELY LOCAL MARKET PLAYERS?



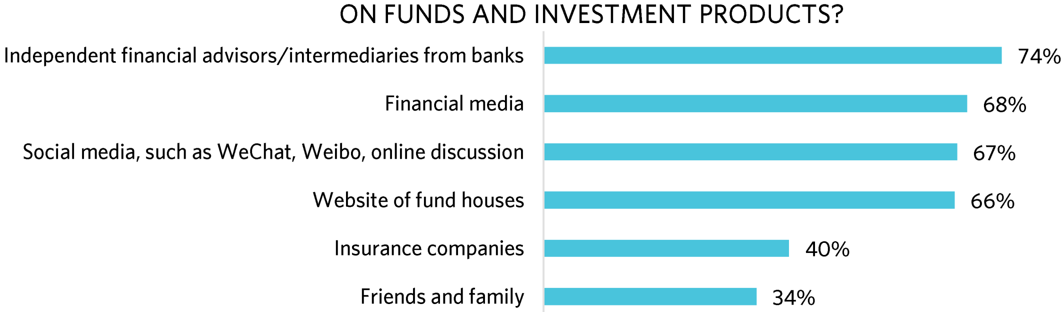
> *Taken together, this would indicate that domestic investors are ready to pay the higher fees associated with foreign brands if these firms can offer not just performance but also the security afforded by a respected name and an opportunity to diversify away from the offerings of local players.*

Another important finding for firms' outreach efforts is that respondents were equivocal on their preferred choice of information channel, with similar numbers favoring Independent Financial Advisors (IFAs), financial media, social media and websites.

Once again, however, personal networks were considered less influential when choosing investment products.

For foreign firms, this may present a challenge because they will need to master multiple, and often unfamiliar, channels to reach their intended audiences in the Mainland.

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



Far from just offering investment products, asset managers have to meet investors' demand for ancillary services. Some are linked to their product offering, which is reflected in the overwhelming demand for good reporting on performance, but there is also a clear interest in areas such as investor education.

WHICH OF THE FOLLOWING SERVICES DO YOU WANT AN ASSET MANAGEMENT COMPANY TO OFFER?

> *Taken together with the 'trusted brand' findings highlighted so far, we believe there is an opportunity to leverage this thirst for education and industry events as effective ways to build brand recognition in key locations through face-to-face interactions with investors.*

In a market that is routinely considered far ahead in its adoption of digital strategies, online patronage for funds was only the second most popular channel, trailing IFAs and intermediaries by 12 percentage points. Insurance agents and brokers were still popular but further behind the above two channels.

It means that digital strategies will need to be a core component of any sales and marketing efforts in China, although the heavy emphasis on IFAs indicates the ongoing importance of people-to-people relationships and the need for trusted figures when it comes to important investment decisions.

PLEASE INDICATE YOUR CHANNELS OF FUND PATRONAGE.

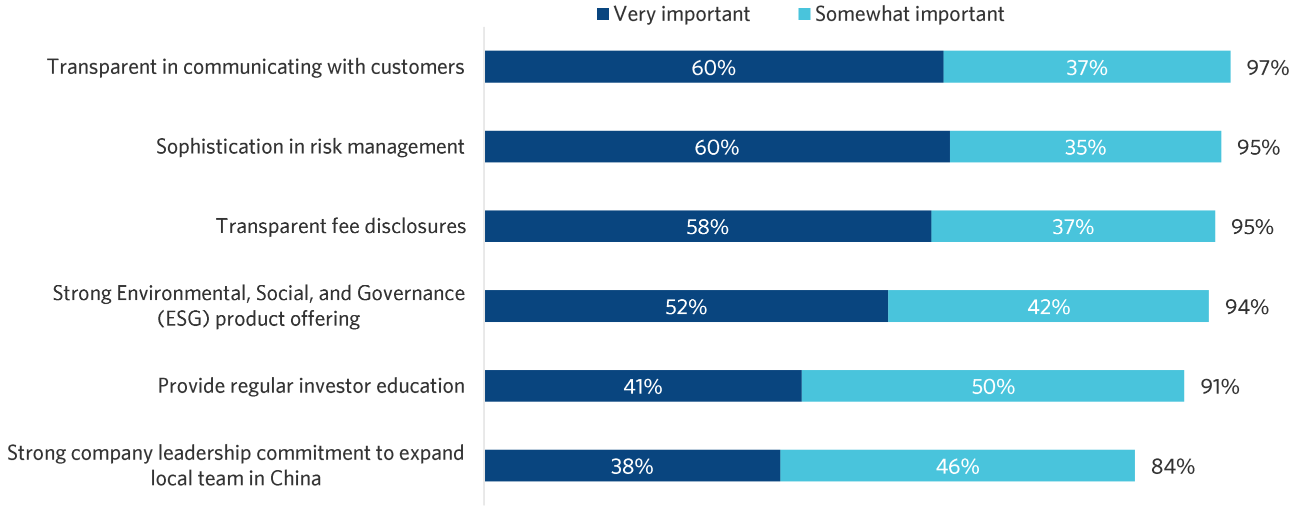
The most important traits in a fund manager are transparency in communications, sophisticated risk management and transparent fee disclosures. This puts the Chinese investor firmly in line with global attitudes toward investment managers and their responsibilities.

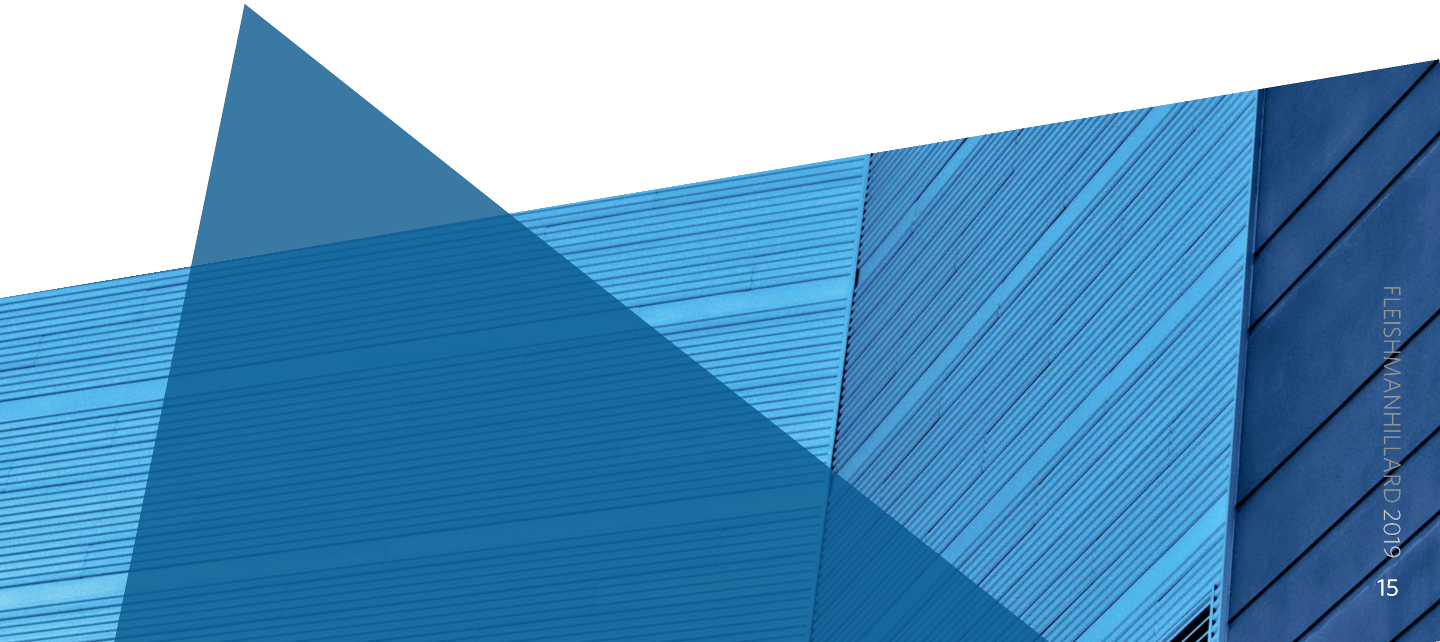
Fifty-two percent (52%) of respondents said ESG was a very important capability for fund managers, and 94% overall for very or somewhat important. While this was not the leading indicator, it was a far more popular choice than many would have expected.

This indicates the success of the top-down green finance campaign that Chinese authorities have been pursuing for years, but it also points to the immense potential for sophisticated global firms to conquer thought leadership — and market share — in this space based on their global expertise.

Among the trailing indicators, only 38% of respondents identified leadership commitment to local expansion in China as very important, a positive for foreign firms that, at least in the short to medium term, will operate in China without a huge on-the-ground presence. Quality over quantity could be a way to summarize such a preference.

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

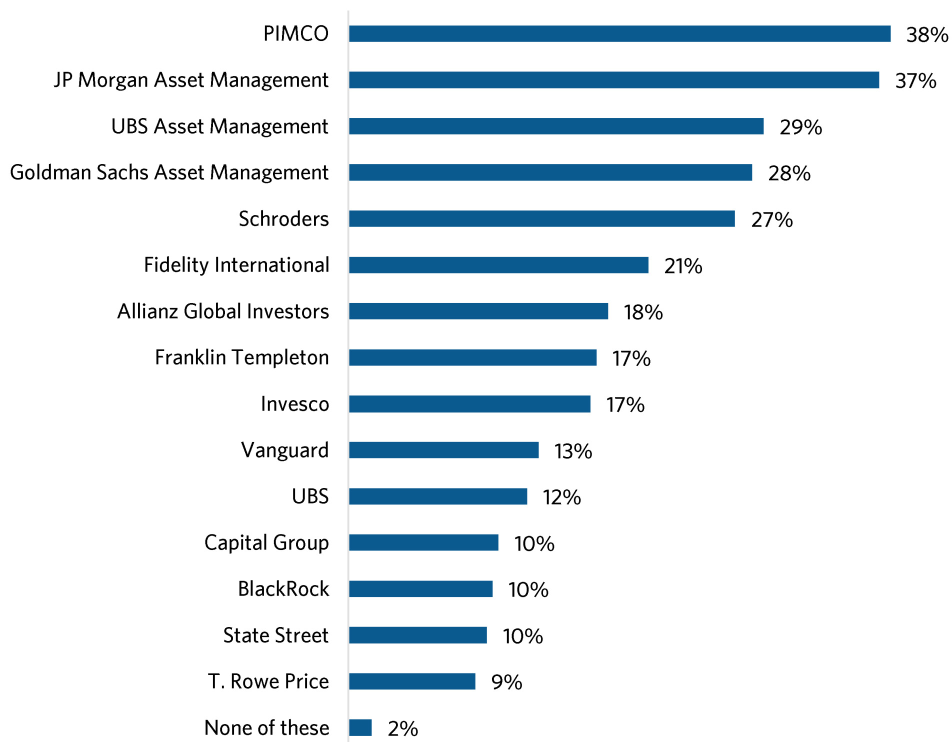




The findings on individual name brands indicate that there is a substantial grouping of brands in the middle.

We believe this chart will remain highly fluid for years to come, as many of the brands have yet to fully go operational with their China WFOEs and the breadth and depth of their product offerings remain limited by licenses. This is still the case for most IM WFOEs, as well as for the slow-moving arrangements with local JV partners.

PLEASE SELECT THREE OF YOUR PREFERRED ASSET MANAGEMENT COMPANIES IN CHINA.



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Concluding Thoughts

We hope you have enjoyed reading through our research and findings on the outlook for foreign asset managers entering China. Looking ahead, we would like to highlight three trends that are likely to shape China's asset management industry, with a particular focus on what that opportunity is for global firms.

BOOMING MARKET

The first, we believe, is the potentially explosive combination of IM WFOEs gaining direct access to the retail market and the, at least, partial liberalization of outbound investment flows under a revised and expanded QDII program.

In September 2019, we saw the regulators announce the upcoming removal of all quota limitations for holders of two inbound investment schemes, the qualified foreign institutional investor (QFII), and RMB QFII programs.

Should such a relaxation be applied to QDII, it would mobilize hundreds of billions of dollars from onshore investors seeking to diversify into a more global portfolio. While such a full liberalization of outbound investments remains unlikely in the short term, a gradual relaxation has been discussed by regulators and market participants for years. This includes the possible return of an RMB-denominated QDII scheme (RQDII), tested years ago, which would allow domestic investors to buy directly into RMB-denominated funds overseas, thereby reducing pressure on the domestic currency's exchange rate.

Whichever shape the outbound flows take, global firms will be the ones to benefit the most given their pre-existing global footprint. The better their brand recognition at the time of such an opening, the higher the likelihood that they will benefit from this business opportunity.

THE PENSION CHALLENGE

Domestically, we believe the severe underfunding of the domestic pension system will provide global firms another opportunity to find a broader foothold in the market. With pension shortfall set to hit US$119 trillion by 2050, according to PwC data, reforms and privatizations will be necessary to meet the massive challenges this will pose.

Pilot programs have already been rolled out, including tax incentives on personal pension products, and regulators have approved the launch of several pension target funds. While the list of firms currently offering them is still subject to regulatory approval and is wholly composed of domestic names, PwC expects foreign firms to feature prominently in that list by 2025. Global brands' existing expertise in pension products, at that time, will prove crucial, especially if their inclusion is combined with the above-mentioned relaxation of overseas investment caps.

TECH PARTNERSHIPS

The role of digital must feature in any forecast on the future of asset management. Chinese tech firms have made their own inroads in the investment management realm, as seen with the success of the record-shattering money market fund operated by Alibaba. Yet, we believe any branching out into more sophisticated investment products by tech firms will see them embrace collaboration with industry players.

And as China's financial market continues to integrate with the global system, more partnerships with well-established global investment managers are all but certain. While such a shift presents a massive opportunity, it will require an equally substantial effort by global firms to lay the groundwork for such tech relationships in the here and now.

Be Bold, Stay True

To navigate the complexity and opportunities in the 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."***

We will be thoughtful and ambitious counselors, candid in our approach, and relentless in our efforts to deliver results and find solutions together. As you embark on your journey in transforming yourself in China's capital market, please count on us to be trusted and effective teammates!

Disclaimer

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Appendix

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