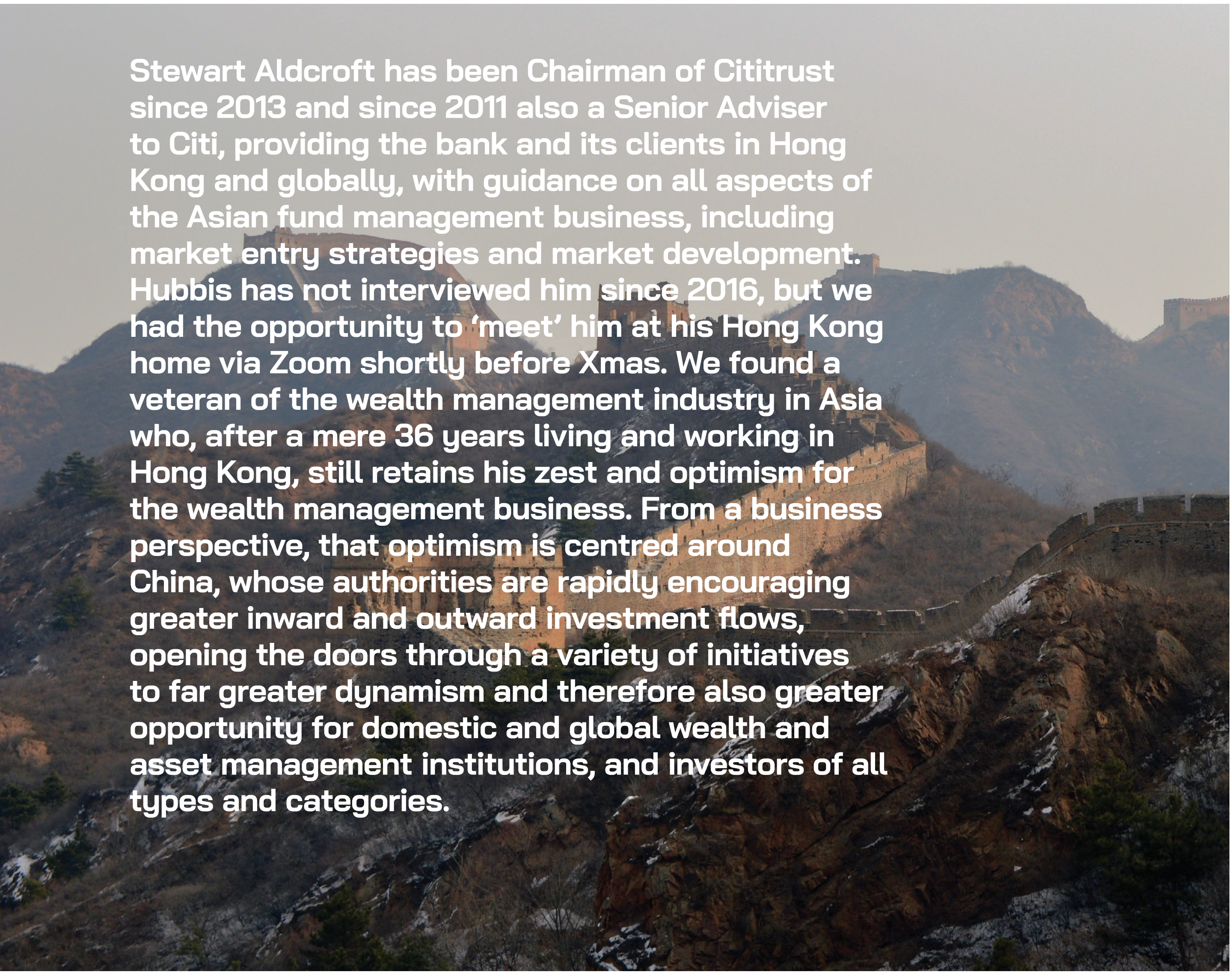
Citi's Stewart Aldcroft on Seizing the Huge Opportunities of China's Accelerating Financial Sector Liberalisation



Stewart Aldcroft has been Chairman of Cititrust since 2013 and since 2011 also a Senior Adviser to Citi, providing the bank and its clients in Hong Kong and globally, with guidance on all aspects of the Asian fund management business, including market entry strategies and market development. Hubbis has not interviewed him since 2016, but we had the opportunity to 'meet' him at his Hong Kong home via Zoom shortly before Xmas. We found a veteran of the wealth management industry in Asia who, after a mere 36 years living and working in Hong Kong, still retains his zest and optimism for the wealth management business. From a business perspective, that optimism is centred around China, whose authorities are rapidly encouraging greater inward and outward investment flows, opening the doors through a variety of initiatives to far greater dynamism and therefore also greater opportunity for domestic and global wealth and asset management institutions, and investors of all types and categories.

Aldcroft opens the discussion with China, which to such a senior banker in Hong Kong has long been a major focus of attention, but which he acknowledges has not been so popular with, or as accessible to, so many wealth management institutions and their private clients until relatively recently.

He notes that the Chinese stock market capitalisation between the three exchanges of Shenzhen, Shanghai and Hong Kong, is now the second largest in the world, after the US, meaning plenty of choice for investors. "China has already become a developed market and is a very well advanced market by comparison to many of the other so-called emerging markets," he observes. "But for many people around the world, their first access to China might actually be through Hong Kong, where some 60% of the Hang Seng Index comprises Chinese companies."

He explains that access to China globally is good and improving all the time, whether directly, through active strategies or the growing array of ETFs. And in the past year, more index providers have been adding China to their global indices so that even large international pension funds have to consider including China in their portfolios.

Aldcroft maintains that the complexity of investing in China and the lack of experience amongst private clients mean it is probably better to leave stock selection investing in China to professionals. "That is why we have seen so much dynamism in China-centric mutual funds around the world and so many ETFs now tracking different parts of the China economic rollercoaster."

Accelerating liberalisation

Aldcroft also reports that the pace of China's opening of its financial markets has accelerated in the past several years, which will spur even greater interest in and access to China in the months and years ahead.

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A key development has been the authorities allowing foreign and global financial institutions to own their own fund management company in China, he reports, with five having applied for licenses and that will start trading in 2021. On top of this Aldcroft notes there are about 32 global fund companies that have created wholly foreign-owned enterprises, not for full fund management licenses but for private fund management, or PFM as it is known, and that will enable them to also offer products in China to predominantly high net worth investors.

"In short," he says, "we now have nearly 40 leading global companies that are very active there." And that should result in a rapid increase in activity and interest, both out to in and in to out.

QFII and QDII

The other avenue by which China has been liberalising access to its securities markets over many years has been via the Qualified Foreign Institutional Investor, or QFII, quota system. "Notably," Aldcroft reports, "as of November the application process was streamlined from 15 lengthy and tricky forms to just three simpler online forms. This is already leading to a sharp increase amongst global financial institutions wanting to avail themselves of that license and obtain the associated quota to invest directly into China."

He adds that the third key liberalisation initiative is the Qualified Domestic Institutional Investor, QDII whereby an institutional investor within China can invest directly into foreign markets.

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Here comes Wealth Management Connect

Aldcroft is also enthused about the Wealth Management Connect initiative, under which any of the roughly 72 million people who live within the Greater Bay Area of 11 cities – including Hong Kong, Macau, Shenzhen, Guangzhou, amongst others – will be permitted to invest up to one million Renminbi into any Hong Kong authorised and Hong Kong domiciled mutual fund. "There is great hope that this will quickly snowball and make a significant contribution to the investment flows within this region," he reports.

He offers more insight into the WMC plan, which has yet to be put into practice but that everyone expects to become operational within 2021. He explains, for example, that the Greater Bay Area represents a combined GDP that would make the region the 12th largest country in the world, bigger for example than Korea or Spain in terms of GDP, and home to more than 250,000 dollar millionaires.

Step by step

"The opportunities for the wealth industry are obvious," he comments. Initially, it will be limited to wealth management products defined as mutual funds and bank deposits, and the funds themselves restricted to only those authorised by the SFC in Hong Kong and that are domiciled in Hong Kong and also that are not deemed complex type products.

"But limitations notwithstanding," he reports. "this is a very positive step and allows for a managed opening of access, and as experience builds, we can only see this becoming a major factor, and we are confident it will be extended later to a much broader range of products and potentially larger amounts per individual."

border travel resumes properly, it will be on hold. But when it does come into operation, certainly we think China's wealthy will seize any opportunity to expand the means by which they can invest their wealth offshore."

He also offers his insights into what the mainland Chinese will be buying once they move funds offshore. "They are seeking a window on the rest of the world," he reports. "Generally, we find they do not want to be in high-risk assets, often they prefer income type products, and I can say that usually, they are actually quite similar in approach to the typical Asian HNW type clients."

"What has changed in recent years is that China has become much more confident about accessing the rest of the world on its own, but actually Hong Kong still has plenty to do and a very strong role in helping investors and business activity of all types overcome many of the challenges of participating in China itself. China is no easy place to do business, as we all know, so Hong Kong is a remarkably successful host to numerous services and solutions to work your way through the different complexities that are China today."

Hurdles still to overcome

Aldcroft comments that this will also serve to reduce or possibly eliminate the other less transparent ways in which funds have migrated out of Mainland China. "The account opening is through a Chinese onshore bank to a Hong Kong partner bank, so it is all transparent and can be easily tracked," he explains. "However, it does at this stage require in-person account opening, so until cross-

Hong Kong remains robust

Aldcroft also comments on the role of Hong Kong as a financial entrepot, observing that for roughly one and a half centuries, Hong Kong has successfully enabled the Western world to access China and helped China to access the rest of the world.

"What has changed in recent years is that China has become much more confident about accessing the rest of the world on its own," he observes, "but actually Hong Kong still has plenty to do and a very strong role in helping investors and business activity of all types overcome many of the challenges of participating in China itself. China is no easy place to do business, as we all know, so Hong Kong is a remarkably successful host to numerous services and solutions to work your way through the different complexities that are China today."

Moreover, Aldcroft observes that in the financial world, the Stock and Bond Connect through the Hong Kong Stock Exchange had really opened China's securities markets up to foreign investment. "Some USD230 billion has been traded in this system over the last five years since it first started," he reports. "It has been remarkably successful, and now with the opening up of China's vast domestic debt markets, there will be great opportunities ahead in fixed income as well."

Aldcroft draws the discussion towards a close by remarking on the sheer scale of China, boasting its roughly 1.4 billion population and a GDP soon to outstrip the US. "And in 2020 alone, there was a massive increase in retail investing into mutual funds, with approximately the equivalent of USD500 billion of new money going into mutual funds and propelling the total industry to roughly USD2.7 trillion.

Stellar activity, stellar returns

He explains that with this scenario, it is no surprise that many new and often excellent products domestically are targeting different segments and sectors, whether new economy, technology, healthcare and so forth. "There is a real groundswell of demand and dynamics in the domestic securities markets," he comments.

In fact, he reports that the success has been so great that the regulators put a limit on the amount raised per new fund or product launch of around USD2 billion equivalent, yet many of these new funds when they were launched, were raising five or ten times that. Part of the background to the success is that many of the so-called 'blockbuster' funds have been achieving 40% or more, and sometimes over 60% returns in the last 12 months. "In short," he says, "we can see they are delivering on returns as well as raising new money domestically; that is a wonderful combination for successful growth in the mutual fund industry." ■

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The US President issued an Executive Order in November 2020 that in effect seeks to prevent US Persons (individuals and institutions) from investing into 35 companies listed in China and Hong Kong that are perceived to have links to the Chinese military. This EO came into effect on 11 January 2021, and may have implications for US individuals. Those who are citizens of other countries are generally unaffected by this EO.