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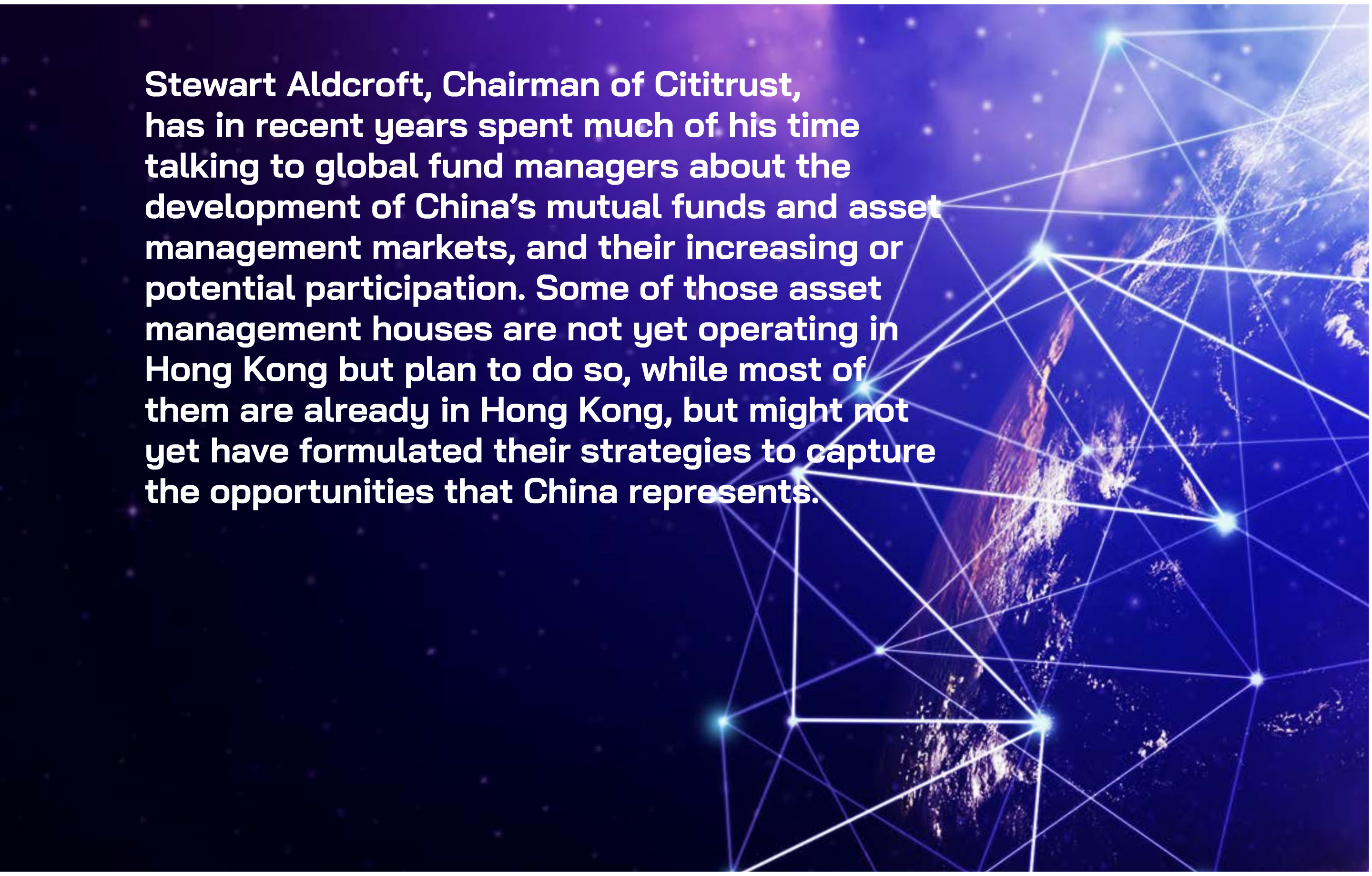
Cititrust Chairman Surveys the Potential for the New Wealth Management Connect Regime



Stewart Aldcroft, Chairman of Cititrust, has in recent years spent much of his time talking to global fund managers about the development of China's mutual funds and asset management markets, and their increasing or potential participation. Some of those asset management houses are not yet operating in Hong Kong but plan to do so, while most of them are already in Hong Kong, but might not yet have formulated their strategies to capture the opportunities that China represents.

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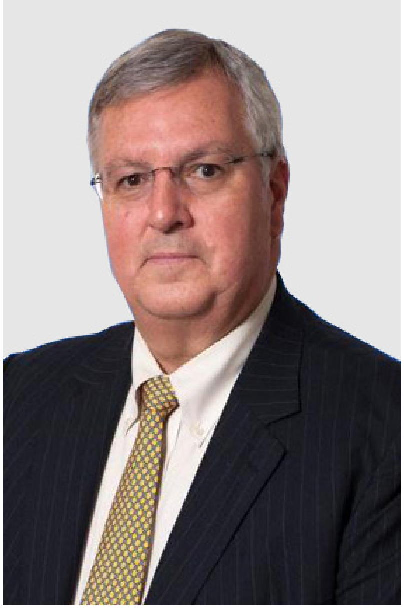

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Aldcroft joined a thought leadership discussion on June 23 that Hubbis organised along with our exclusive partner for the event, Allfunds, focusing on the potential for the new Wealth Management Connect (WMC) regime to open up two-way investment flows within the Greater Bay Area (GBA), home to more than 72 million people and GDP of some USD1.6 trillion.

Following that discussion, Hubbis has taken the opportunity to present this Q&A with Aldcroft, based on some of his comments during the discussion, and also largely based on a "thought leadership" paper he wrote for Citi titled 'Why do Global Fund Managers need to set up Local Funds in Hong Kong?' .

He reports that in the entire span of 35 years plus that he has lived and worked in Hong Kong, the local mutual fund industry has been dominated by Undertakings for Collective Investment in Transferable Securities (UCITS), which are funds domiciled in Europe. But he reports that new regulations aligned with the opening up of the Greater Bay Area provide an opportunity for global fund managers to offer their expertise to individual investors and eventually beyond the GBA to the rest of Mainland China, but via locally domiciled and authorised funds.

The potential is vast, as an estimated – and astonishing - 6 million Mainland Chinese investors have already acquired domestic mutual funds, of which more than 200 million are invested in securities markets, and that the mutual fund industry already stood at roughly USD3.5 trillion at the end of May 2021, around double the level of less than three years ago. In short, the rapidly swelling ranks of Mainland Chinese mass affluent investors are eager to buy into global assets and doing so compliantly through approved funds domiciled in Hong Kong will be a great way of starting that ball rolling, opening up significant opportunities for the wider wealth management community.

Can you set the scene for our readers?

The Greater Bay Area, or GBA, has a population of around 72 million, and is therefore bigger than all European countries except Germany. There is a Gross Domestic Product (GDP) across the GBA region of roughly USD1.6 trillion, which exceeds that of California, making it equivalent to one of the top 12 economies in the world.

The High-Net-Worth Investor (HNWI) population in the GBA exceeds 280,000 families, which represents more than 20% of the total in Mainland China, and is one of the fastest growing anywhere in the world. Many of them look to Hong Kong for guidance on where to invest money outside Mainland China.

Until now, many GBA residents have, through various means, been able to get some money into bank accounts in Hong Kong, from where they can then invest worldwide. The banks and private banks in Hong Kong have benefited substantially from this flow of money from Chinese customers, and thus so also has the Hong Kong mutual fund industry through which much of the money has been invested.

We now have Wealth Management Connect (WMC), which was officially announced on 29 June 2020, and that will soon be live and then rolled out in phases. This is important because the door to invest via Hong Kong has through this been widened well beyond the Mainland Chinese HNWI population to include anyone in the GBA with sufficient assets to qualify.

These investors are mainly mass affluent individuals, and they will henceforth be able to go to their local bank – anywhere in the GBA - and make investments via eligible Hong Kong funds into their preferred securities markets and assets worldwide, or into bank deposits and certain types of bonds cross border through their chosen bank. At the same time, Hong Kong and Macau residents will be able to invest northbound into China.

While in the initial stages, there will likely be a quota limit of RMB1m (US$155,000) per person, with an aggregate investment potential of around RMB150bn (US$23.2bn) in each direction, this development must be considered one of the best opportunities anywhere for the global fund management industry.

So, that means in effect, people within the Greater Bay Area can be buying into funds and other investments through Hong Kong, and people in Hong Kong and Macau could be buying mutual funds in China.

The types of funds that will be allowed are only Hong Kong domiciled funds, and Hong Kong SFC authorised funds. They will have to be classified risk rating 3, 2 or 1, in other words, meaning medium risk or lower. They cannot include derivatives, or higher risk assets or structures, so these are relatively simple, non-complex products.

And are global asset management firms preparing their businesses to seize the potential?

Under the terms of the GBA WMC regulations, only mutual funds that are domiciled in Hong Kong, with investment management carried out in Hong Kong, will be eligible.

This is very similar to the situation that has existed for over five years with the Mutual Recognition of Funds (MRF) regime, which is an 'access scheme' allowing the cross-border sale of mutual funds between Hong Kong and Mainland China. But the global asset management groups have seen that MRF has been very slow, and that to date, only 32 funds from Hong Kong have succeeded in getting approval for sale in Mainland China, whilst there are only 50 Mainland China funds approved for sale in Hong Kong.

The result is these global asset managers are adopting more of a wait and see approach to the opening up of the new WMC regime. And for the time being, most of them don't yet see the real value in setting up domestic mutual funds in Hong Kong when they can so easily keep selling UCITs funds locally to numerous investors across the world. However, there is hope that WMC will result in the lengthy approvals process that MRF has suffered from – many months and sometimes years for approvals – being eliminated, as no additional (to HK SFC) approvals are required for funds to participate in WMC.

What does it all mean for the global fund managers?

Put simply, licensed asset management firms can make use of their existing licenses already granted by the Hong Kong Securities & Futures Commission (SFC) to also create domestic funds domiciled in Hong Kong. These can be set up very simply and easily as either unit trusts or as Open-ended Fund Companies (OFC), which first became available in Hong Kong in 2019 and that have almost identical criteria to unit trusts in terms of set up.

They can be created in umbrella or single fund format, with no tax implications. The fund format chosen needs to be approved under Section 2, Chapter 7 of the Hong Kong Mutual Fund Code, to also be acceptable for use in the context of the WMC.

I should also explain that for Mainland China investors, OFC are very similar to the format of their domestic mutual funds, making it far easier for them to understand the structure. They are also very similar to UCITS, and thus ideal for UCITS managers to operate.

And will this all result in a major burst of activity?

We believe it will certainly boost local activity, as these new eligible funds should be managed by local licensed personnel in Hong Kong, and for those funds that then invest into global stock markets, they can also be sub-advised by specialist teams in London, New York, Tokyo, or wherever, as appropriate.

These funds can include feeder or especially fund-of-fund (FoF) products, but it is unlikely, at least in the initial stages of the GBA WMC, that pure feeder funds will be acceptable for use, so the main focus should realistically be on developing fund-of-funds. Notably, the underlying funds in a fund-of-funds format can be UCITS funds from the same management group, as I mentioned earlier, provided they have already been authorised by the SFC in Hong Kong.

It can also be fairly assumed that Mainland Chinese investors will want to use these eligible Hong Kong funds to invest globally, which surely means a fillip for activity in Hong Kong focused on the rest of the world.

There is a requirement for these funds to have a low- to medium-risk rating requirement of between 1 and 3, and eligible assets include equities, fixed income and cash, meaning multi-asset funds are probably best. These funds should not use derivatives, leverage or other artificial devices that may enhance performance, but also at the same time increase risk levels.

Whilst most global fund managers will have investment teams in Hong Kong that provide specialist advice on the Greater China and Asian stock markets, now they can fairly easily use their skills to also set up funds to meet the expected needs of the new GBA WMC market.

Although global fund managers have not yet been able to gain access to Mainland China's potential 1.4 billion population market, where over 200 million people have invested into mutual funds already, they can now create local Hong Kong products that can then use their UCITs vehicles.

We also expect the authorities involved in Hong Kong and China to develop this WMC regime over some years in a multi-phase approach. Right now, it will start as focusing on the mass affluent segment and with considerable limits on the investment levels per individual, with a limited range of low to medium risk funds, and with execution only and no advisory involved, but we expect that to evolve over the coming years, via new phases of WMC, so asset managers and the broader wealth community can position themselves for that future. All in all, WMC is therefore a major game changer, we believe. ■

Find out more by viewing Stewart's insightful thought leadership presentation entitled 'Riding on Wealth Management Connect (WMC) in China's Greater Bay Area (GBA)'.