

An aerial photograph of Shanghai, China, taken at sunset. The sky is filled with orange and yellow clouds. The Oriental Pearl Tower is prominent on the right side of the image. The Huangpu River flows through the city, with several bridges and buildings visible. A large white circle is overlaid on the center of the image, containing the title and subtitle.

# Global Meets Local

Mapping the implications of  
China opening up its markets



STATE STREET



China is increasingly relaxing its regulation toward foreign investors, easing the path for overseas institutional investors looking to access China's capital markets. Yet challenges persist as global meets local.

President Xi Jinping used the Boao Forum for Asia in April 2018 to decree that China would further deepen economic and financial reforms and facilitate greater access to its markets for foreign investors. In November 2018, Xi reiterated that China “will enter a new phase of opening up” including its US\$45 trillion financial industry.<sup>1</sup>

#### **Easing into equities**

One major area of focus has been the accessibility of China's rapidly growing capital markets. China introduced the Shanghai-Hong Kong Stock Connect in 2014 and expanded the scheme to Shenzhen in 2016, giving offshore investors access to China's equity markets.

Regulators have taken a multitude of steps to attract overseas asset managers and asset owners to Chinese shores. In June 2018, China's foreign exchange regulator – State Administration of Foreign Exchange (SAFE) – further eased restrictions on foreign institutional investors, increasing the amount that a Qualified Foreign Institutional Investor (QFII) can repatriate each month, and removing lock-up

periods for both QFII's and RMB Qualified Foreign Institutional Investors (RQFII's). At around the same time, the People's Bank of China (PBOC) issued circular 159 which allows offshore RMB Participating Banks to provide liquidity to foreign investors under the RQFII and China Interbank Bond Market (CIBM) direct schemes.<sup>2</sup> In January 2019, SAFE further doubled the QFII quota to US\$300 billion for the first time since July 2013.<sup>3</sup>

Global institutions are paying attention. The MSCI introduced China A shares to its emerging market indices for the first time in May 2018, with a 5 percent weighting. It subsequently doubled this to 10 percent in May this year, and plans to lift the representation of Chinese shares to 20 percent by November.<sup>4</sup> The United Kingdom's FTSE recently announced it too would add China-A shares to its indices. Following completion of the first stage, Chinese stocks will represent an initial 5.5 percent of the FTSE Emerging Index, and will draw an inflow of US\$10 billion from passively-managed funds, according to a statement from FTSE.<sup>5</sup>

<sup>1</sup> [http://www.xinhuanet.com/english/2018-11/05/c\\_137583815.htm](http://www.xinhuanet.com/english/2018-11/05/c_137583815.htm)

<sup>2</sup> <http://www.pbc.gov.cn/zhengwugongkai/127924/128038/128109/3558796/index.html>

<sup>3</sup> <http://www.safe.gov.cn/en/2019/0118/1486.html>

<sup>4</sup> <https://www.scmp.com/business/china-business/article/3010079/global-index-compiler-msci-begins-process-lift-chinese>

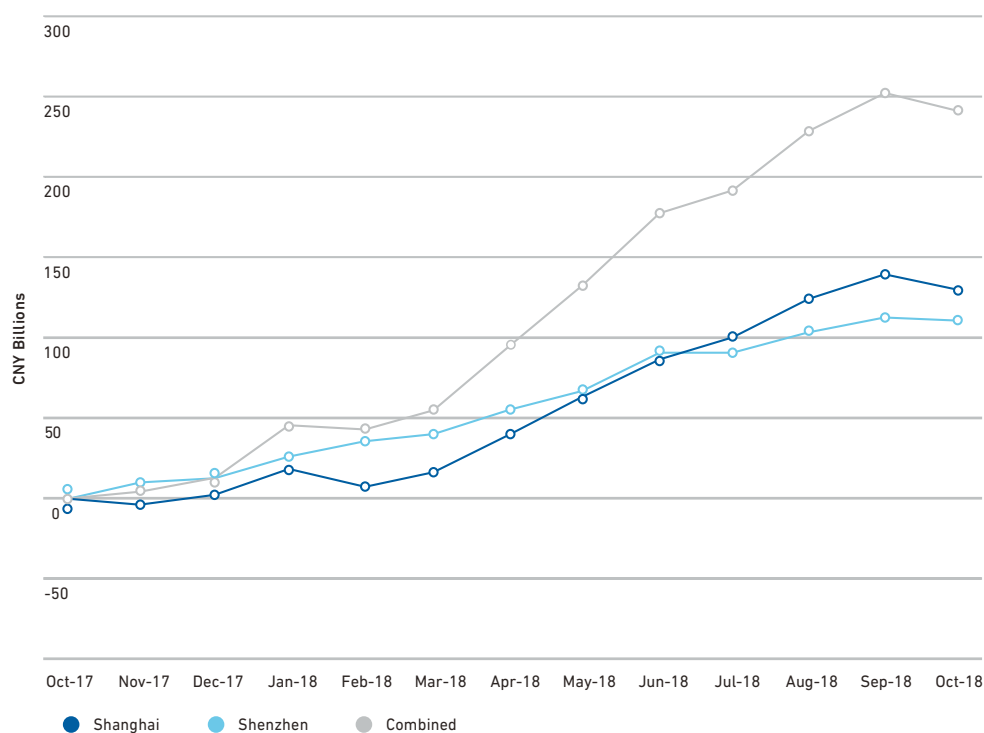
<sup>5</sup> <https://www.scmp.com/business/china-business/article/2165903/uk-index-compiler-ftse-russell-add-chinese-stocks-its-global>

Foreign investors responded by ploughing approximately US\$30 billion (CNY \$250 billion) in the past year through the northbound Stock Connect – funds that originate in Hong Kong and are invested

in China. However, with only around 3 percent of the US\$5.6 trillion domestic A-Shares market owned by offshore buyers, this is just the tip of the iceberg.

**Figure 1: Cumulative offshore buying of China A Shares**

Cumulative Northbound Net Buying



Source: Premia Partners

### **Buying into bonds**

And it's not just stocks. China has also relaxed rules in the bond market, which is already the world's third-largest pool of capital behind the United States (US) and Japan. China's Bond Connect scheme was launched in July 2017 to provide greater efficiency and convenience to enable offshore investors to trade bonds on the domestic market through Northbound trading.

Investors can leverage the Hong Kong infrastructure including the Central Moneymarkets Unit (CMU) to access the China Interbank Bond Market (CIBM), avoiding the need to create a new onshore relationship to manage trading and settlement. Unlike with stocks, there is no daily quota restriction.

As with stocks, China's bonds are expected to be added to global indices in 2019.<sup>6</sup> The Bloomberg Barclays Global Aggregate Index has included yuan-denominated securities from April 2019. Based on January 2018 data that will equate to 5.5 percent of the US\$5.7 trillion index that is followed by many of the large insurance and pension fund schemes.

### **An irreversible trend?**

In his keynote speech at the opening ceremony of the Boao Forum for Asia, 10 April 2018, President Xi described economic globalization as an irreversible trend and suggested the same for China's financial opening up.

There is a continual effort from Chinese regulators to expand the product scope for foreign investors. While foreign investors still have restricted access to the scope of products listed in the China A share market they can buy, further liberalization that allows depository receipts and derivatives trading, has increased options for hedging purposes to make the market more appealing.

China's commitment to reform should not be underestimated — though US trade policy represents a potential headwind. President Xi and President Trump met on the sidelines of the G20 Summit in Osaka, Japan in June 2019. Both sides agreed to restart trade negotiations. The US agreed to hold off on new tariffs on \$300 billion of Chinese imports while China agreed to buy more US agricultural products. Further opening up of the financial services sector is one of the areas that China committed to moving on.

<sup>6</sup> <https://www.bloomberg.com/company/announcements/bloomberg-confirms-china-inclusion-bloomberg-barclays-global-aggregate-indices/>

### **Too big to ignore: Implications for overseas institutions**

The caveat for foreign investors in Chinese securities has not been about whether you can make a profit, but whether you can get your money out. Chinese regulators have gradually relaxed restrictions on repatriation in response to ongoing lobbying efforts from foreign investors and market participants. Although access to China's shares has gone global, support infrastructure and administrative services have remained local.

While global providers of custodian services have been lobbying Chinese regulators for quite a few years, they are still not formally recognized in China. One major concern is that Chinese regulation sets entrance thresholds including large capital commitments, and a prolonged review processes for foreign bank branches. Another concern for investors is how to reclaim their investment in case of insolvency of the local service provider. A key issue for investors using Stock Connect is whether they have any proprietary rights or beneficial ownership rights under Chinese law.

Yet despite certain challenges, the majority of international fund managers and clients have come to accept these as the price of doing

business. While US companies were labelled "Too Big to Fail," China's are already "Too Big to Ignore" and are now available to global investors on a much more level playing field.

### **Accessing China's pool of wealth**

The growth in China's markets has evolved without much help from domestic investors, who are now also being steered toward more sophisticated products. China has the world's biggest pool of savings, with more than 95 percent of the population's personal assets held in deposit accounts rather than financial instruments.

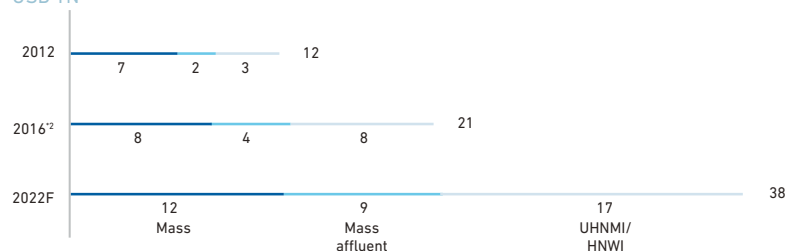
In a white paper by international management consulting firm Oliver Wyman, assets under management in China's finance industry are predicted to grow by more than 10 percent per annum over the next five years, almost doubling to US\$14 trillion from US\$7.4 trillion in 2018. Growth will be fueled by the increasing affluence among China's high net worth individuals as well as a burgeoning middle class that is expected to steadily shift assets into mutual funds and away from deposits and real estate.

With that type of potential tailwind, foreign investors should be happy to connect.

**Figure 2: Personal Wealth and Institutional Assets Under Management in China**

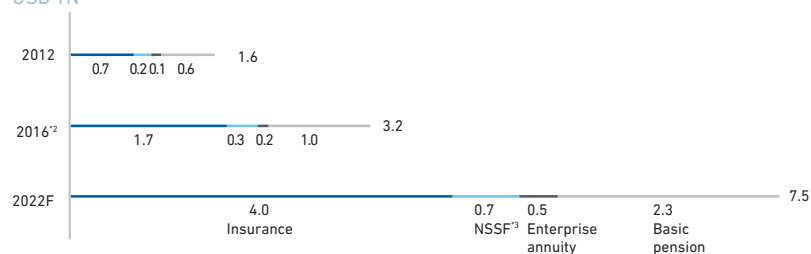
INDIVIDUAL<sup>\*1</sup>:

TOTAL INVESTABLE ASSET  
USD TN



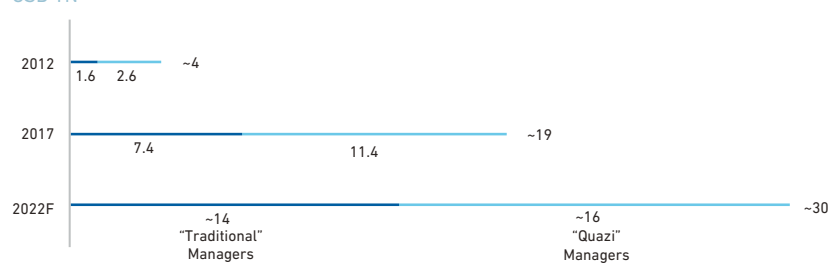
INSTITUTIONS

TOTAL MANAGED ASSETS  
USD TN



CHINESE ASSETS MANAGEMENT

INDUSTRY: TOTAL AUM  
USD TN



Source: AMAC, CIRC, CSRC, CTA, CBRC, WIND, National Council for Social Security Fund, Ministry of Human Resources and Social Security, Forbes, Credit Suisse, World Bank, Oliver Wyman analysis

<sup>\*1</sup> Definition by household investable asset: HNWI = RMB 6MM or above (~USD 1MM or above); Mass affluent = RMB 0.6 MM – 6 MM (~USD 0.1MM – 1MM); Mass = Below RMB 0.6MM (Below ~USD 0.1MM)

<sup>\*2</sup> 2017 figures not yet available

<sup>\*3</sup> National Social Security Fund

Source: Oliver Wyman

<sup>\*</sup>Oliver Wyman: Global Asset Managers in China: Riding the Waves of Reform. 2018

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