Welcome to EY’s inaugural China asset management report. China’s asset management industry finished 2021 with a record-high Asset under Management (AUM) and now is the world’s second largest onshore market by EY estimates. While the industry has delivered strong growth in 2021, the intensifying competition, rising customer demand, and a changing regulatory environment bring up new challenges. In this report, we will review the key drivers of the industry development, make forecast on what lies ahead, and give EY’s suggestions on what preparations to make for the future.
Total AUM by the members of Asset Management Association of China (AMAC) stood at RMB68 trillion, or US$10.79 trillion, at the end of 2021. By our estimates, China now is the world’s fourth largest asset management market, after the US, Luxembourg, and Ireland. It is also the second largest onshore market, next only to the US. AMAC lists fund management companies (FMC), registered private fund managers (PFM) and securities companies as its members, but does not account for sub-scale PFMs. Neither does it include the third-party assets managed by insurance asset management companies (AMC), pension insurers, wealth management companies (WMC) or trust companies. If these assets are included, then the size of China’s asset management industry is closer to RMB100 trillion, or US$16 trillion.

Compared with 2020, industry’s AUM has grown by 15.25%, the fastest in 6 years. Most of the growth was achieved on the back of sustained demand for mutual funds and private funds, as well as the capital appreciation of equity-centric products.

Mutual fund products claim the lion’s share of the industry. At RMB25.3 trillion, the sector accounts for 37.2% of the industry’s total AUM and is the largest pillar. This is also one of the fastest growing sectors, with a 27.1% year-on-year growth, and a 5-year CAGR of 22.5%. More impressive than the AUM growth, is the growth of the management fee. The total fee collected by FMC stood at RMB92.4 billion in 2020 and RMB135.2 billion in 2021. This represents a 11.83% CAGR from the RMB30.2 billion in 2010.

FMC manage the most mutual fund products, though a growing list of companies, including securities firms, private fund managers and insurance asset managers, now offer mutual fund products too.

While retail investors in China usually access professional asset management through mutual fund products, private funds are mainly bought by high-net-worth individual investors, and occasionally institutions. PFM collectively reported a total AUM of RMB19.8 trillion upon the end of 2021 and were the second largest pillar of the onshore industry, with a 5-year CAGR of 20%. The PE/VC funds are the largest subsector of private funds, with a year-end AUM of RMB12.8 trillion. It is followed by private securities funds, which mostly invest in the secondary market.
While the mutual fund and private fund business have seen strong growth, other sectors of the industry have been stagnating, if not shrinking. The most flagrant are the separate account business. Originally intended for FMC and securities firms to offer HNWI and institutional investors more customized investment solutions, this part of the industry, at RMB1.5 trillion upon the end of 2021, have mostly been used as pass-through vehicles to securitize private loans to real estate developers. Since the introduction of the New Asset Management Rules, which urges any kind of the pass-through business to be wound down, FMC and securities firms’ separate account business has been in decline.

Consolidating core

So exactly what is the “New Asset Management Rules?”

The New Asset Management Rules, or “Guiding Opinions of the People’s Bank of China, the China Banking and Insurance Regulatory Commission, the China Securities Regulatory Commission, and the State Administration of Foreign Exchange on Regulating the Asset Management Business of Financial Institutions,” was jointly issued by People’s Bank of China, China Banking and Insurance Regulatory Commission, China Securities Regulatory Commission, and State Administration of Foreign Exchange, to introduce better accountability to the rapidly growing business of private funds, trust products, banking wealth management products and separate account business. We have listed key aspects relevant to the subject of this piece below.

- Prohibition to guarantee positive returns or safety of principals. For years many banks’ wealth management products and trust products have been sold to investors with a guarantee of return or at least principal safety, either explicitly or implicitly. The New Rules put an end to it and instead asked distributors to inform the buyers of investment products of the risks, while ensuring sales suitability.

- Regular disclosure of net asset value. All investment products are required to disclose a net asset value, calculated on a fair-value basis.

- Asset segregation and asset-liability matching. Product manufacturers can no longer run commingled funds and have to ensure the shares of the products they offer are matched with underlying assets.

- Restrictions on wrapping and leverage. All products are prohibited from investing in other types of financial investment products, except for mutual fund products. The Rules also made stipulation on the max leverage ratio that can be applied by different types of products.

- Clarification of jurisdiction. Types of institutions and products subject to the New Rules are defined.
Quickly expanding boundary

AMAC members aside, more financial institutions are moving into the asset management business. Among them the insurance AMC are the early movers. Originally set up as the incorporated investment department of the largest insurers, a growing number of insurance AMC have been building up their investment management capabilities. Currently most of the money managed by insurance AMC is from other insurers or pension plan sponsors, a growing number of them are eying third-party money. Some are aiming for retail business by preparing to obtain mutual fund licenses.

Trust industry has always been closely related to asset management business. Many trust companies have been working closely with PFMs for the past decade, but content with just providing the legal vehicle and never very interested in actually managing the money. That is changing though. The changes introduced by the new asset management rules has forced trust industry to seek new growth engines and a growing number of them have picked asset management as the new pivot. Trust companies will face stiff competition, but their ambidexterity in product manufacturing and distribution bodes well for those that can muster both resolves and resources.

And lastly WMC are the latest to make inroads to the asset management business, and perhaps the most menacing to the incumbent players. Originally set up as special-purpose vehicles to accommodate the wealth management products spun off from banks, these managers have gone under transformation to assert a more active role in China’s wealth and asset management business. They are endowed with distribution access and a large balance sheet. In the first year of their operations, they have managed to deliver strong results, despite having to cope with the challenges that typically faced a new industry. As WMC mature, they have strong incentive to build out their asset management capabilities too.

![Third-party assets managed by insurance AMC (CNY Tr; 2017-2021)](image)

Source: Public information, IAMAC, EY Analysis
We expect the AUM growth of China’s asset management industry to accelerate, though in the immediate future mutual funds and private funds might need some time to regroup, after years of neck-breaking growth.

There are several forces behind the projected growth. Firstly, though still governed by multiple agencies, the new asset management rules have provided China’s asset management industry with a unified regulatory framework. The new rules levelled the playground for different types of asset managers. And its focus on product design, disclosure, and sales suitability, make goal-based investment and long-term financial planning easier, thus bolstering the long-term inflow.

Secondly, multiple cycles have cemented fixed income as the anchor of China’s capital markets as well as its asset management industry. The mutual fund industry now sees more than 60% of its open-end funds’ AUM in bond and money market funds. RMB4.1 trillion bond funds now have a track record of longer than five years and an accumulative return from inception of more than 5%. Should there be a downturn in the stock market, the fund industry still has attractive products to offer its customers.

The money market and fixed income products not only serve as an AUM stabilizer of the industry, the steady cash flow they bring in also allow managers to invest in initiatives that only can be expected to pay back in the long run, such as technology upgrade and investor educations, critical initiatives that pave way for sustainable growth.

Lastly, the digital channel has brought in a new, younger generation of investors. Compared with their parents, who are the current core investors of the industry, these new customers usually have a longer investment horizon and a faster growing income. The fund flows generated from this demographic provides the industry with additional growth fuel.

What to expect?

What will not change

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The entrance of the new investors, as well as increasing sophistication of the incumbent ones means that Chinese investors’ demand for their asset managers is also becoming higher. We think the higher demands will be felt the most in three areas: advice, digital engagement, and sustainable investments.

As the products available become more diverse, and the investment horizon longer, Chinese investors’ need for financial advice is also growing. Most popular advisory services among Chinese retail investors include investor education, product comparison and selection, goal-based saving assistance, visualized report and analytics, and regular portfolio monitoring. Compared with the transactional services Chinese investors used to get, such services greatly improved the customer experience. Most investors now obtain such advices from outside of the asset management industry though, usually from the so-called disruptors (FinTech startups or affiliates of large technology firms), but there are signs that asset managers, banks and brokers are gearing up to include advice in their propositions too.

Along with more demand for advice, Chinese investors are also demanding a higher level of digital engagement. In fact, it is almost impossible now to build a service delivery model in China without going fully digital. This migration of the customer journey is accelerating along with the arrival of the abovementioned digital/mobile native investors. Their expectation to monitor and manage their investments on a 24/7 basis, along with other demands including low latency, better user interface, and seamless combination of human touch, has urged Chinese asset managers and distributors to rethink their digital representation.

The last pressure point is around sustainable investments. Like many other markets in Asia-Pacific, Chinese investors are demanding more Environmental, Social and Governance (ESG) investments although currently the focus is more on the environment pillar. This newfound passion is partly spurred by China’s recently announced carbon neutrality ambition, and partly fueled by the revaluation of related assets in the local market and the consequent trading opportunities. The immediate response from managers is to bring more responsible/sustainable investment products to the market. In doing so, however, managers should be careful not to greenwash the current practice and start thinking about the broader transformation needed to deliver upon investors’ expectations.
Intensifying competition

The promises of the industry attract new entrants. FMC, as the most versatile and most open asset management platform, attracts the most. As the industry becomes more crowded, managers will feel more fee pressure and higher human resources and distribution costs. A more congested industry also makes it more difficult for managers to stand out, a particular challenge for new and smaller firms.

The diverse background of new entrants also put more competitive pressure on the incumbent players. While historically FMC are sponsored by a consortium of strategic investors (securities firms, trust companies, banks) and financial ones (various types of holding companies, large state-owned enterprises with excess cash), most of the new FMC are set up by a new force: foreign asset managers, individual star portfolio managers, and occasionally the spun-off investment department of securities firms and insurance companies. The intruders are more likely to try new ways of doing business, and therefore pose a bigger disruption, if not threat, to the existing players.

Private fund industry will also attract more entrants, as the AUM continues to grow. But compared with the mutual fund industry, private funds will remain a more accommodating theatre for new and small managers. This is also the reason why it will continue to attract individual star portfolio managers of the mutual fund industry and foreign asset managers new to the China market to open their own business via PFM first.

At the periphery of the asset management industry, trust companies, insurance AMCs, and WMCs will also continue to fight for third-party assets in their own way, while seeking the necessary licenses that will recognize their legitimacy.
What to do?

Product innovation

In anticipation of the growth of the core business, managers should continue investing in their products. While the industry now certainly does not have a shortage of products, it does suffer from a lack of product diversity. As the competition intensifies, managers should use product innovation as a differentiator insomuch as a value lever to serve investors. While the industry probably does not need another vanilla bond fund or equity fund, we do have identified two types of products still in short supply. The first is products that aggregates the manager’s capabilities in different asset classes, markets and even investment strategies: multi-asset, multi-income, and multi-strategy products. The pension fund of funds are probably the best examples of such products, but much more can be done. We expect these products to replace vanilla products as the core of Chinese investors’ portfolio.

The other product innovation trend is taking the opposite approach towards the same goal. A manager can modularize their products so that investors can configure their own portfolio. Managers with the largest index funds and ETFs are probably at the best starting point, but we believe it is the smaller firms that are better positioned to capture the most upside in the long term. Being nimble allows them to focus on a niche that requires simplicity more than anything else. A modularized product suite and the underlying approach also allows the manager to work more closely with the other players on the financial services value chain, which itself is quickly becoming modularized.
Rise of alternative assets

Compared with the core assets, we expect the alternative side of the industry to grow faster. This is started by the New Asset Management Rules and fueled by the ongoing changes of investor preferences. The new rules, while cutting down the pass-through/wrapping business, actually give rise to a better regulated and more wholesome alternative asset management industry. Since the introduction of the new rules in 2018, we have seen Chinese HNWI and institutional investors buying not less, but more private equity and private credit assets. The consequent increase of these assets’ valuation in turn further boosted the demand. In addition to the attractive returns, the low correlation between alternative assets and core assets makes them a sensible addition to the current portfolio. And lastly, private assets are usually a better lever for managers and investors to pursue responsible and sustainable investments.

All these made building and growing an alternative asset management business both a commercial imperative and a regulatory necessity for most asset managers in China. PFM historically are and will likely continue to be the largest manager of alternative assets. The insurers and insurance AMC, as the major institutional investors in China, have scrambled to acquire alternative investment management capabilities, especially in real estate and private equities space, in response to accounting rules changes and a new risk-based capital scheme. Even FMC, who are traditionally associated only with public stocks and bonds, are also offering alternative asset management to retail investors in the form of mutual funds.

Source: Public information, AMAC, EY Analysis
Distribution

Managers will need to be prepared for a more costly, and sometimes, more exclusive distribution channel. The traditional value chain where distributors (usually banks) take care of distribution and asset management companies are responsible for product manufacturing is giving way to a more convoluted model, as distributors, whether they are banks, advisors or technology firms, creep into product manufacturing. Asset managers, on the other hand, have yet to match with the same level of initiative and steadfastness. We think asset managers can upgrade the distribution of their products with three initiatives. The first is to diversify within the banking channels. Despite the congestion, regional banks as distribution channel for asset management products remain underpenetrated. The resources needed to acquire your third or fourth national banking partner will pay off better by investing in a regional and even provincial one. The second is to foster better relationships with technology companies. While the longer-term alignment is much less certain, the technology firms will be content playing a partner role rather than bulldoze the whole value chain in the foreseeable future. Working with technology companies’ distribution agents does require a more nuanced strategy, as they usually only serve a distinct demographic. As a result, some may be more comfortable with selling low-risk products and some are only good at selling equity products.

And the last distribution initiative is to work more closely with securities companies. Like the regional banks, securities companies are being overlooked because it is difficult to amass billions of inflows from even the biggest securities company. But security firms’ clients are usually more sophisticated and more likely to buy equity-centric products. This is in stark contrast with banking customers’ fixation on fixed-income products. Brokerage channels are also cheaper, and more flexible about the size of the managers they work with. Private fund managers have seen initial success from working with their prime brokers, but securities companies’ distribution prowess and potential have yet to be fully recognized by the broader asset manager community.

Talent

Product and distribution aside, the biggest bottleneck of the industry is its human resources. Industry has felt the pain of portfolio manager shortage, but the affliction goes beyond that. Good investment analysts, as portfolio managers, are also always difficult to come by. And as we will see, IT professionals are quickly becoming the new contested asset of asset managers. And mid-office teams are also in needs of expansion, as they become inundated by the rapid growth of institutional business. All this is compounded by the incessant incursion of new entrants, which makes established managers the target for poaching.

In addition to the incremental approach of continuous hiring, asset managers should also start investing in a more coherent HR management process as a solution to the talent problem. A more rigorous process yields long-lasting benefits of independence from star portfolio managers. When combined with technology enablers, it also allows higher level of automation and thus reducing cost and operational risks from human errors. Having in place an uncompromising, codified process will allow the manager to scale up the business more quickly too.

The last response is to upgrade the incentive schemes. More FMC are using employee stock ownership plans (ESOP) as a way to incentivize. This is most apparent among the industry leaders and new entrants but should be included in every manager’s human resources policies, irrespective of the size. And when state ownership prevents direct ESOP, other performance-based incentives like profit sharing should be considered. This in return allows the asset management company to stipulate a more stringent investment mandate and more scrupulous performance reviews.

Technology

Asset managers will also need to increase technology expenditure. Different kinds of asset managers in China now have very different approach towards their technology infrastructure, usually depending on what kind of assets they are managing and if they are in retail or institutional business. On the retail side, FMC enjoy running a sleek system that works well in China’s highly automated stock and bond markets, but increasingly struggles with practically all kinds of other business (alternative assets, cross-border fund flows, institutional business). Insurance AMC usually run on heavily patched legacy systems, which managed to deliver the operations needed for an institutional fixed income business but has come under pressure as the business scope expands. WMC are becoming the touchstone of the next-generation systems. Or guinea pig, depending on how you look at it. Across the board, asset managers will need a more efficient and resilient technology infrastructure to meet the rising demands from regulators and investors, as well as to work with a more diverse base of partners along the value chain. A strategic approach urges the managers to look at several possibilities more open-mindedly: the next-generation technologies, a new relationship with vendors, and to increase the technology expenditure from the current level, which we estimate to be 1% of the revenue, to 3-5%, depending on how big the AUM base is.
Seek corporate development opportunities

A linear industry value chain is quickly giving way to a coopetition, and if we can pardon the cliché, almost ecosystem model. This means the asset managers in the traditional sense, i.e., the ones listed in the beginning of this article, should be prepared to interact with more entities in the market, and to form multiple, if not conflicted relationships with the same counterparts. For example, they will compete with their biggest institutional clients and their biggest distribution partners for AUM, while keeping the competitive tension from spoiling the existing cooperation. While some managers have reacted to this paradigm shift with indifference and even renunciation, we argue that proactive corporate development actions should be at the heart of all kinds of asset managers in China and there are clear early mover advantages in such actions. One of the immediate options is to set up dedicated platforms as interface of such relationship. For example, some leading asset managers now have subsidiaries that offer financial planning or alternative asset management services. For FMC, securities firms, and trust companies, doing so out of a subsidiary will likely make various otherwise conflicted incentive schemes possible. It will also make the firewalling easier and thus ensures the long-term flexibility of the organization. These platforms can also serve as base to apply for additional licenses, such as the fund investment advisory license.

The second corporate development option is to seek new types of partnerships. While in the immediate future, WMC seems to be a channel access reserved for foreign managers, in the long term, we expect banks to become open minded towards new ways of working with external managers and all product manufacturers should prepare for and maybe seek such opportunities. Insurers can be receptive towards teaming up with asset manager in their AMC business too. And the newly sanctioned financial holding companies are the third types of candidates for asset managers to try new partnership with.

And lastly, we think asset managers should prepare for merger and acquisitions. Removal of restrictions on foreign ownership will likely lead to some foreign managers exiting the current minority joint ventures. This creates deal opportunities for companies like securities firms, insurers, trusts and even PFMs if they seek mutual fund license and the scalability offered by retail asset management business.

Beyond the strategies

Over the years Chinese asset managers have proven to be both astute and resourceful. The challenges they face now, however, require them not only to do what they are good at even better, but also to try new ways of doing business and even to build entirely new business. Such is the new era that the regulatory development has ushered the whole industry in. While the full implications can only be felt in the long term, immediate actions are needed to prepare for the changes ahead. And the transience of the window makes the required initiatives all the more critical.
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