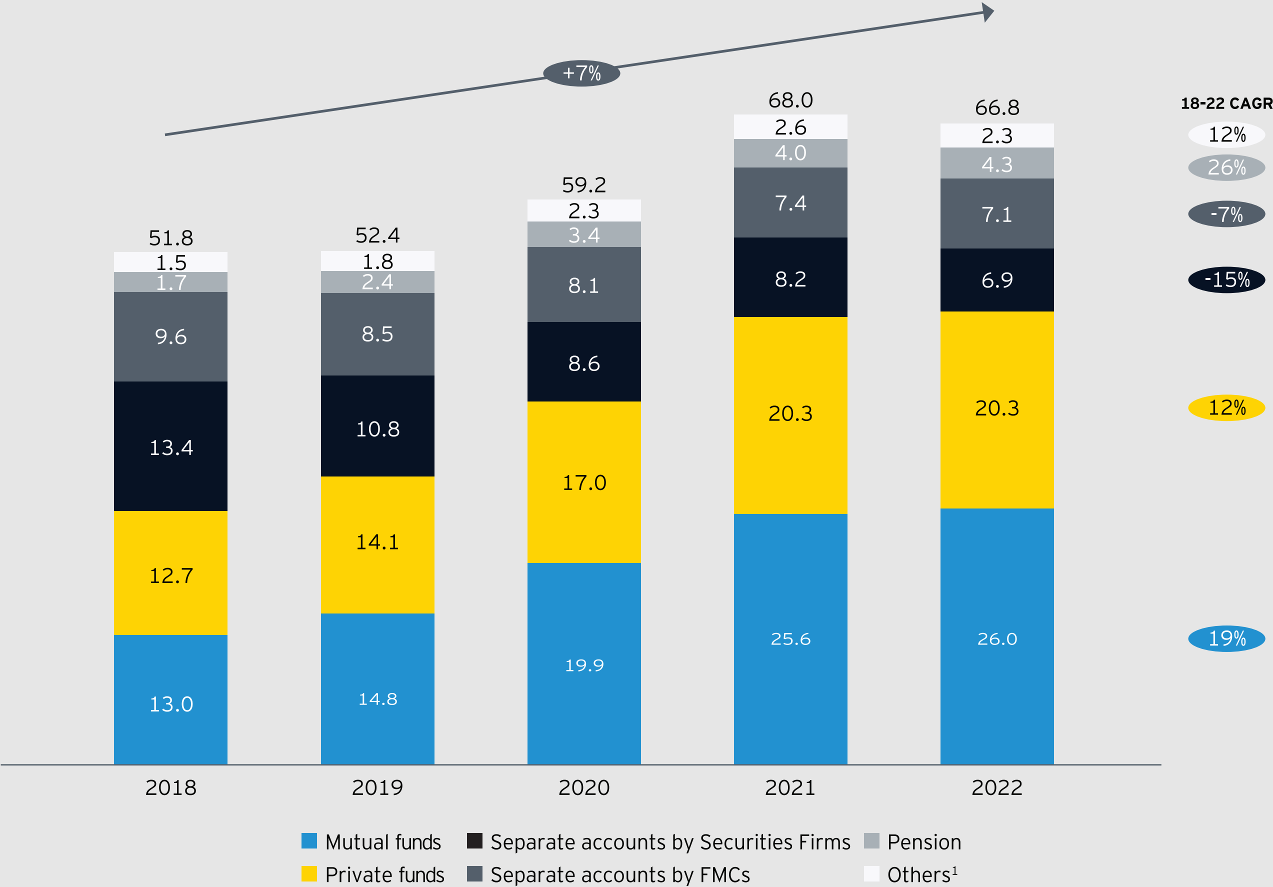
China Asset Management Report 2023

Welcome to the EY organization's new China asset management report. For those who follow China's asset management industry closely, 2022 left a mixed taste at best: a sluggish stock market dampened the demand, but the introduction of a new private pension scheme gave hope for renewed growth. Pandemic made business logistically challenging, but travel restrictions and social distancing rules were lifted at year-end . Industry size remained flat, but structural changes continued. In this report, we identify 10 key trends and give our take on how each of them will shape the future of the industry.

Industry remained resilient

Total assets under management (AUM) of China's asset management industry dropped slightly from CNY68 trillion in 2021 to CNY67 trillion upon 2022 year-end,ending a winning streak that started in 2018. Considering that the major index, Shanghai composite, was down by 15%, industry did well with asset retention. More than anything, the decrease was attributed to the continued regulatory clamp down on separate account business, which has been halved since the introduction of the New Asset Management Rules in 2018. Both the private funds and the mutual funds, the dual engine of the industry, managed to bring in new assets on the back of a strong 2021 and were both helped by relatively high fixed income exposure. Overall, the industry managed to stay on its long-term growth trajectory, finishing 2022 with a five-year compounded annualized growth rate of 7%. We expect the long-term macro factors, including the deepening of the capital market, growing investor awareness and appreciation for professional asset management services, improved distribution outreach, will continue to fuel industry growth.

Chart 1: Total AUM of the China asset management industry (CNY trillion, 2018-2022)



Sources: AMAC, EY Parthenon Analysis

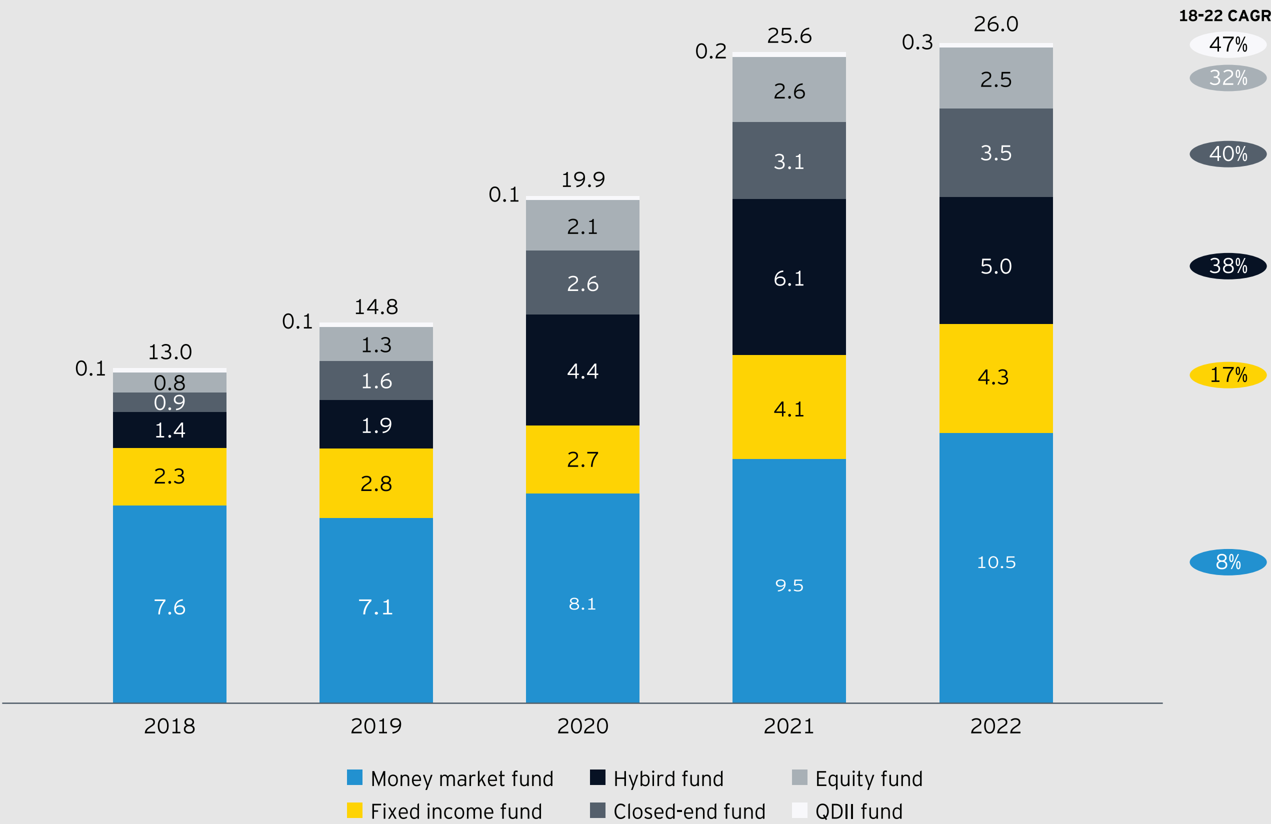
[1] Others include futures companies' commodity trading advisors and asset-backed securities

Mutual funds still the core

Mutual funds remained the biggest sector of China's asset management industry and managed to grow despite increased volatilities in the stock market and the consequent pressure on fund returns. The industry finished 2022 at CNY26 trillion, CNY400 billion more than a year before. The difference made it the biggest contributor of the industry's AUM growth.

While it is encouraging that the industry continues to post growth in spite of external volatilities, it is also conspicuously reliant on new funds for AUM growth. In 2022, a total of CNY1.7 trillion was raised by new funds, or 400% of the industry's net growth, compared with 54% in 2021. Against the backdrop of what is going on in the stock market, bond funds and money market funds have, perhaps unsurprisingly, once again replaced equity-centric products as the growth engine of the industry. The two product types collectively accounted for 70% of the new fund raised. While in 2021, the same number was less than 30%. While it is soothing for the embattled industry to have a lifeline, it is also alarming for the fund management companies to rely on new purchase of fixed income products, and ultimately distributors, to maintain the size. As we have seen between 2018 and 2022, it is more difficult for managers to build long-term track record and differentiate with fixed income products, and this consequently inflates distribution cost and weakens customer retention.

Chart 2: AUM of China's mutual fund industry by product type (CNY trillion, 2018-2022)



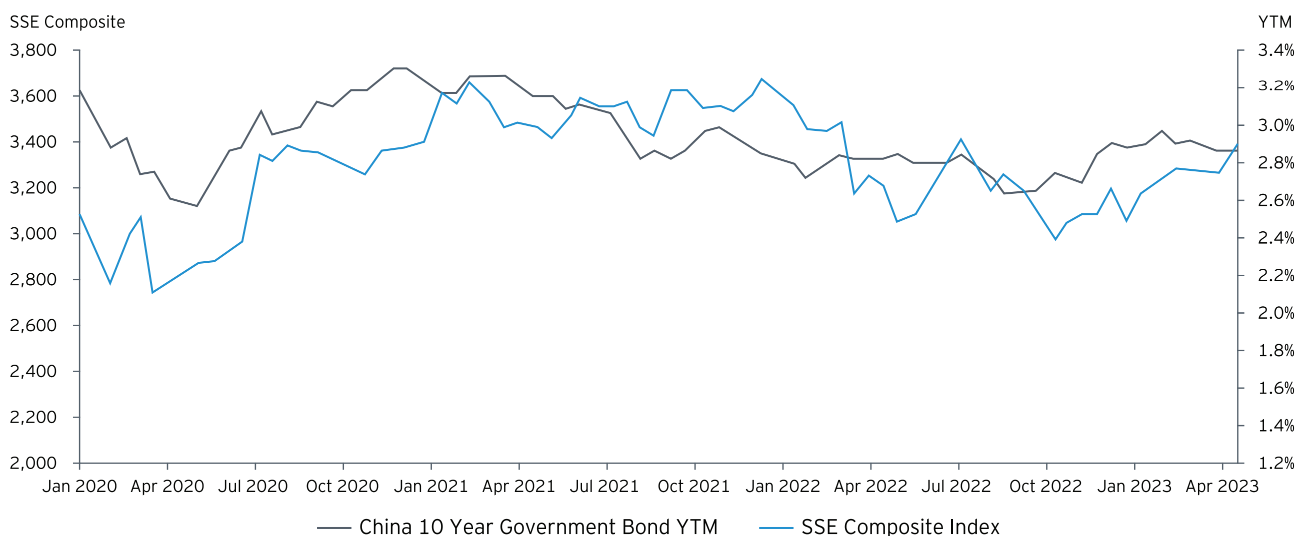
Sources: AMAC, EY Parthenon Analysis

"Fixed income plus" wanes

The so-called fixed income plus has been the most popular products since 2019. But in 2022 its luster finally started to wane. The reason is multifold: on the "fixed income" side, while China still enjoys a low interest rate environment, to what extent the central bank will continue to pursue credit expansion is now much more questionable. The growing disagreement about where the bond market is going is best evidenced by the increase of bond trading volume. The uncertainties of the prospect of the bond market are compounded by a quickly shrinking credit risk premium, as the market regained confidence after several default cases in 2021. The lack of credit risk premium further plunges the appeal of bonds among investors.

On the "plus" side, the equity market also increasingly struggles to deliver a return that matches the expectation of the investors. Subsequently more and more "fixed income plus" managers are being forced into the alternatives, making the space increasingly crowded. In addition to asset supply, engineering a "fixed income plus alternatives" strategy to deliver the required return predicates on regulatory attitude, managers' capabilities and distributors' readiness, all of which are bigger assumptions in 2022.

Chart 3: Changes of SSE Composite Index and China 10 Year Government Bond Yield to Maturity (YTM) (2020 to 2023)



Sources: SSE, ChinaBond.com, EY Parthenon Analysis

And most critically, the convergence of fixed-income assets and risky assets' returns have defeated the purpose of such a strategy. As we can see from the chart above, treasury bonds and all-market equities have shown high correlation since 2020. This makes the success of the strategy increasingly a case-by-case question and weakens the appeal of the products.

It is noteworthy however that Chinese investors may have looked beyond public equities, but they certainly have not stopped looking for complements to their existing portfolios. As we will see in the next chapter, demand for multi-asset and multi-strategy solutions remains strong.

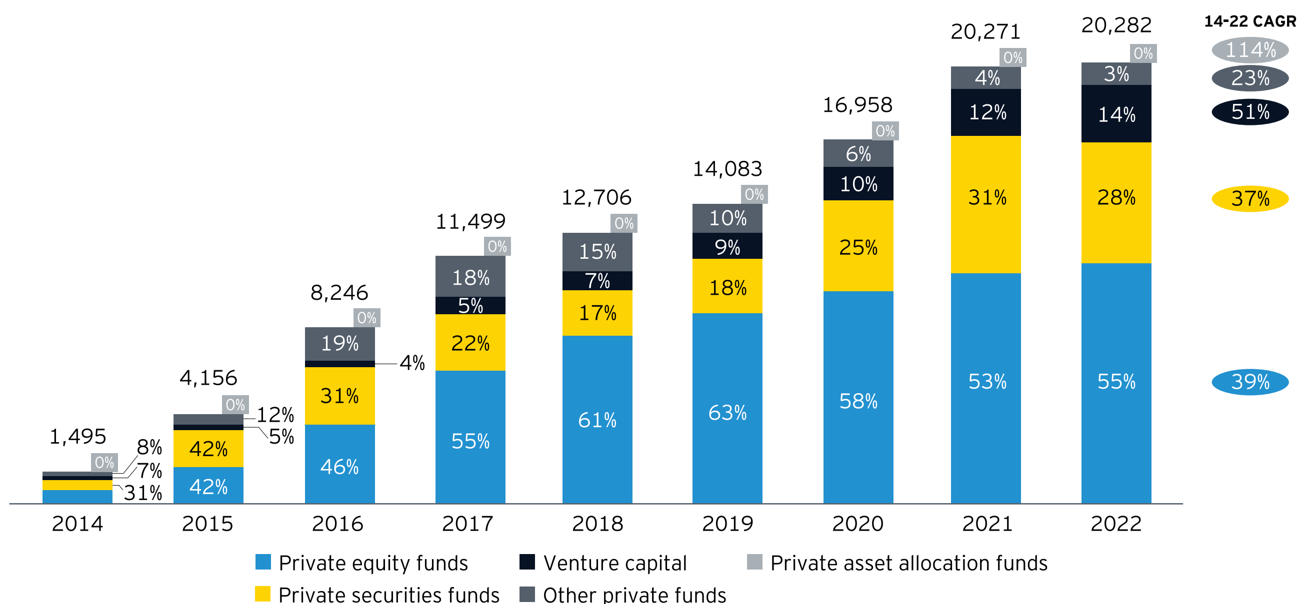
Demand for alternative assets continues to grow

Years of regulatory development has sanitized rather than sterilized alternative investments in China. More so than ever, they are now an integral part of Chinese investors' portfolio. In fact, sustained demand is an ostinato of 2022 across almost all sectors of the industry and likely a crescendo in the longer term. A prolonged low-interest rate environment and increasing pressure to lift investment returns have led institutional investors including insurance companies, sovereign wealth funds and corporate investors to seek high returns in properties, private equities, hedge funds and other types of alternative assets. High-net-worth individuals (HNWI) have also been forced to alternatives, as the banking wealth management products where they used to screen for bargains came to a stop.

For the asset management industry, the biggest beneficiary of the alternative boom are the private fund managers, who collectively finished 2022 with a total AUM of CNY20.3 trillion, a slight uptick compared with 2021. PE/VC funds were the most vivid sector with a CNY818.6 billion growth of AUM. PE/VC managers raised CNY445 billion in 2022. VC funds were growing much faster than PE ones, thanks to its tax advantages, but the distinction between the two is more and more blurred.

The other pillar of the private fund industry, private securities funds (PSF), also benefited from sustained demand. Total AUM registered a retreat from CNY6.3 trillion to CNY5.6 trillion, on the back of a 15% slide in the stock market. It was helped by new inflow from new fund raising of about CNY240 billion during the year. Collectively PSF exhibited no distinction from the index returns, not in 2022 at least. As a result, PSF managers have become reliant on new fund raising for AUM growth, just like their mutual funds cousin. If this problem persists, it will turn into profitability and growth issues for the industry.

Chart 4: AUM of China's Private Funds industry (CNY billion, 2014-2022)



Sources: AMAC, EY Parthenon Analysis

5 The fastest growing business just got faster, but requires new approach

Pension has long been the fastest growing sector of China's asset management industry. It is a fact that usually gets ignored or neglected though, as for the better part of the past, pension asset management business (investment management mandates from enterprise/occupational annuities plans and National Council for Social Security Fund (NCSSF) has been reserved for a select few.

The battle is shifting to a new frontier though, and that is the pension fund of funds (FoF). As one of the four major product suppliers of the newly introduced private pension scheme, fund managers have seized preemptive advantage. Upon the end of 2022, 21 managers collectively managed over CNY100 billion of pension FoF assets.

This new business, however, does require competing managers to upgrade their capabilities. On the client-facing side, all contenders need to find a retail outlet for a traditionally institutional business. On the operational side, the very design of FoF requires the managers to offer a broad range of assets, an ask that is beyond the reach of most mid and lower-tier managers now, as most of them have usually been focusing on one core asset class (either equity or bonds).

For more details about China's pension reform, please refer to our *Pension Annual Report*.

25%
25%
2500
2000
1500
1000
500
0

ESG investments take roots

ESG investments got a boost when in 2020 China committed to the target of carbon peak by 2030 and carbon neutrality by 2060. The commitment is an overarching socioeconomic goal but has significant bearings on the investment management industry too. The first to pick up was NCSSF, a long-time vanguard. The sovereign wealth fund issued its first global ESG mandate RFP in 2020. And in 2022 there was announcement that it would increase its investment in ESG-themed funds. In August 2022, the Fund announced its first overseas responsible investment mandate. In November 2022, NCSSF issued its first domestic ESG mandate. Additionally, the Fund also issued its guidance on industrial investments, in which it mentioned that it would increase allocation to ESG-themed funds and incorporate ESG factors when performing due diligence and performance evaluation on its industrial investments.

Insurers have been the other key proponent of ESG investment. According to China Banking and Insurance Regulatory Commission's (CBIRC) data, insurers had more than CNY1 trillion in green investment by 2021 year-end, or 4% of its total investments, doubled from the year before. The allocation of insurers' ESG investments is in line with its strategic asset allocation, where about 70% goes to green bonds, 20% to industrial investments and the rest to stocks. Insurers also seem open minded toward using external managers for ESG investments.

Retail investors have also been keen to increase ESG investments. Both private funds and public funds have been gearing up their ESG effort to keep us with the demand. On the public side, there are now 606 ESG or responsible investment funds, with a total AUM of CNY435 billion. According to Asset Management Association of China's (AMAC) 2022 publication, *Asset Managers' Annual Green Investment Self-Evaluation Report*, two-thirds of the surveyed fund management companies (FMC) have brought a green investment product to the market, and more than half have listed green investment as one of the firm's strategic priorities.

Regulators and policymakers have responded to rising demand with more clarity. Since 2021, there has been a clear acceleration of regulatory development, in the hope of paving the way for long-term development of ESG in the industry as well as sustainable and green investment.

Table 1: Key policies and guidance on green finance and ESG in recent years

Date	Policy/ guidance details
Sep 2016	The People's Bank of China, along with The Ministry of Finance and other ministries issued the "Guidelines for Establishing the Green Financial System", encouraging long-term funds such as pension funds and insurance funds to carry out green investment.
Nov 2018	The Asset Management Association of China (AMAC) issued the "Green Investment Guidelines (For Trial Implementation)", urging fund management institutions of domestic and overseas pension funds to play an exemplary role as responsible investors and work proactively to establish a long-term mechanism in line with green investment or ESG investment norms.
Sep-Oct 2021	The State Council issued the "Working Guidance for Carbon Dioxide Peaking and Carbon Neutrality in Full and Faithful Implementation of The New Development Philosophy" and "Action Plan for Peaking Carbon Emissions before 2030". Relevant departments and units will formulate carbon peak implementation plans for areas including energy, industrial, urban and rural construction, transportation, agriculture and rural areas, along with other specific industries. Regions will also formulate its own carbon peak action plan in accordance with the plan requirements.
Nov 2021	The People's Bank of China launched carbon-reduction supporting tools to offer incentive and guide funds to invest in green and low-carbon fields and sectors.
Dec 2021	The Ministry of Ecology and Environment, the National Development and Reform Commission along with other ministries launched the "Pilot Program of Climate Investment and Financing", with measures to guide and promote more funds to invest in climate change related activities, and to realize the country's determined contribution goals and low-carbon development goals.
Jun 2022	The China Banking and Insurance Regulatory Commission (CBIRC) issued the "Guidelines on Green Finance for the Banking and Insurance Industries" to promote awareness and ask for relevant organizational management in place.
Jul 2022	The China Green Bond Standards Committee published the "China Green Bond Principles", marking a milestone in the development of China's green bond market with unified standards and integration with the international markets.

Sources: State Council, NDRC, People's Bank of China, CBIRC, AMAC, China Green Bond Standards Committee, EY Parthenon Analysis

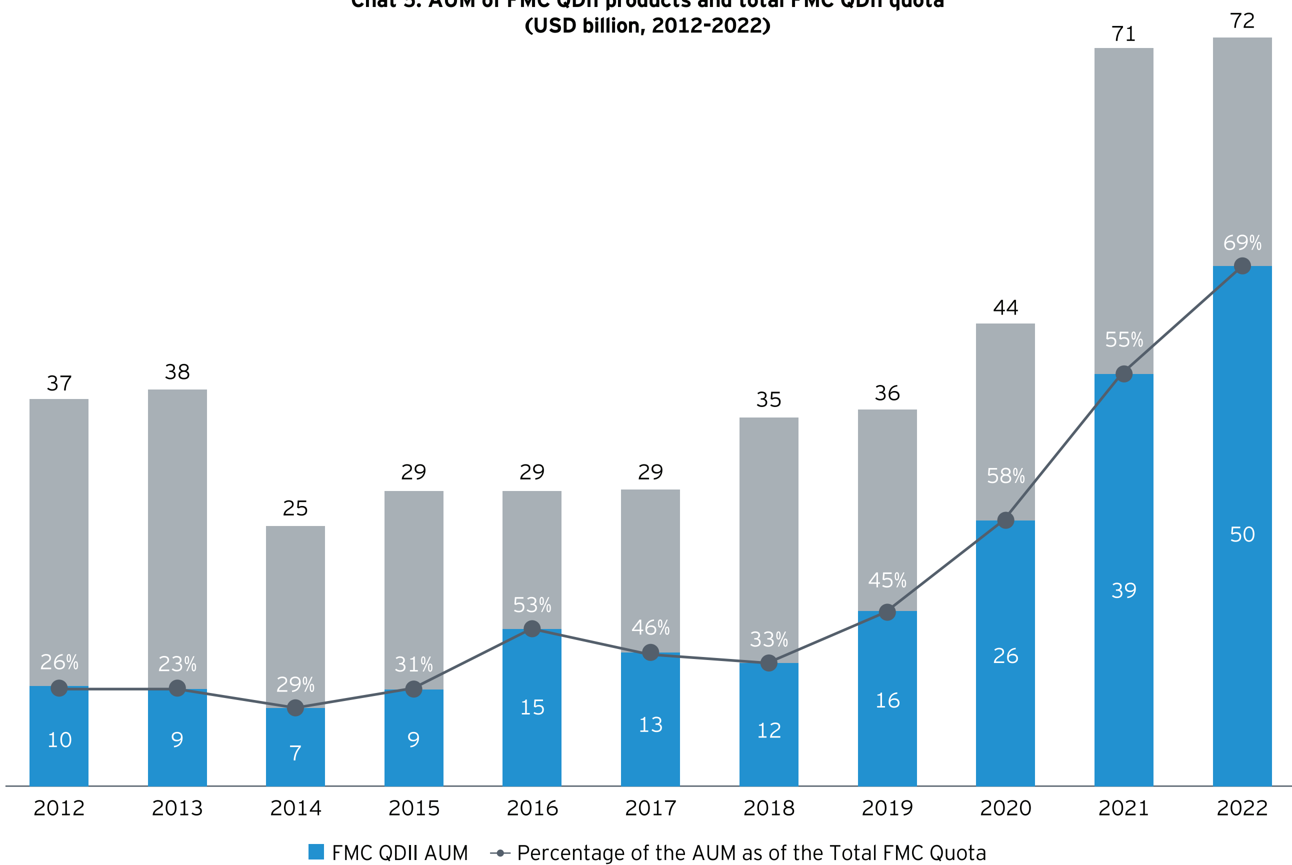
Most of the fund managers, however, are still midway on their ESG buildout journey. The talent war for ESG specialists has been the immediate pressure point of the industry, but the survey reveals more gaps in human resources, data, policies and procedures and other operational capabilities.

More cross-border fund flow and more foreign managers

Despite growing geopolitical tensions, Chinese investors' appetite for overseas assets remains strong, and regulators continue to provide license and quota.

Qualified domestic institutional investor (QDII) remains the largest outbound investment channel. Total QDII quota has gone from USD85.6 billion in 2012 to USD159.7 billion in 2022, registering a compound annual growth rate (CAGR) of 6.4%. The number of FMC QDII funds has gone from 67 in 2012 to 222 in 2022. Total AUM of FMC QDII products registered a five-fold growth in the last decade. The growth was partly fueled by increasing investor sophistication and diversification needs, and partly explained by ongoing effort by managers to bring more interesting QDII products to the market. Despite the impressive growth, proportionately QDII mutual funds' AUM still only accounted for a percentage of the industry's total. It requires more fundamental changes before the product class can see a significant increase.

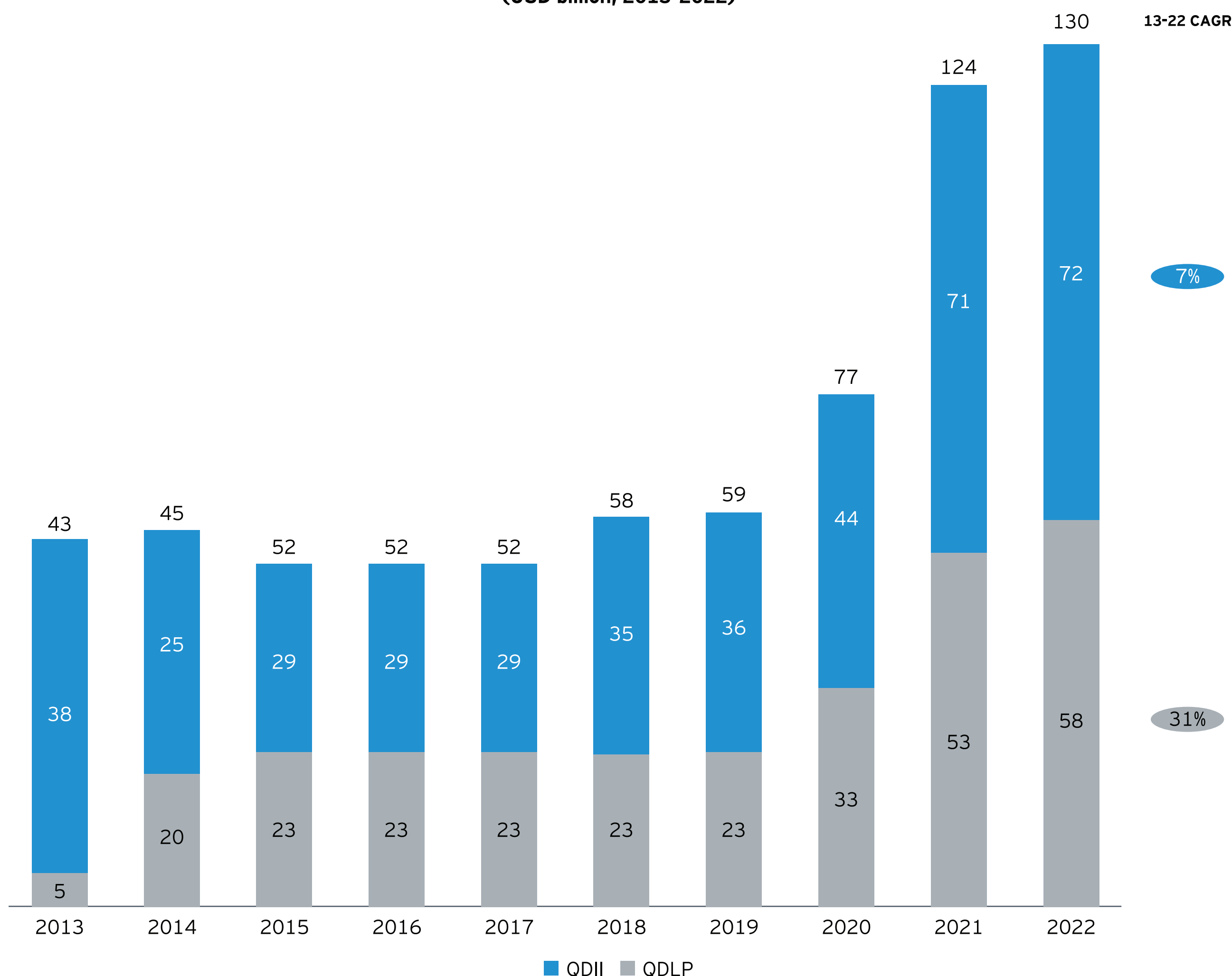
Chat 5: AUM of FMC QDII products and total FMC QDII quota (USD billion, 2012-2022)



Sources: AMAC, SAFE, EY Parthenon Analysis

On the other hand, Qualified Domestic Limited Partnership (QDLP) is catching up with QDII quickly in terms of total quota granted. QDLP, initially launched as a regional program to attract global asset managers in Shanghai, is quickly becoming a key channel for HNWI investors across the country to invest offshore. More flexibility in product choice and direct access to a more sophisticated client base give higher hopes that QDLP will continue growing at a fast pace. But the program itself is not without challenges. The program still needs the endorsement from a broader community to achieve critical mass, national status and full legitimacy, lest another two-year moratorium on quota issuance.

Chart 6: Total QDLP and QDII quota granted by the SAFE (USD billion, 2013-2022)



Sources: SAFE, EY Parthenon Analysis

The other measure to further open China's asset management industry is the accelerating admission of foreign managers into the onshore retail market. China now reports seven wholly foreign owned FMC, compared with one in 2021. The year of 2022 also saw the first batch of joint ventures being topped up by their foreign shareholder to wholly foreign owned. Most, if not all, of the first batch will need to go through a transition period and their full potential cannot be felt until later. But domestic peers will be rash to dismiss the threat. As we have seen in the wealth management and pension business, foreign competitors have exhibited successful track record of overcoming seemingly insurmountable challenges through focus and differentiation.

High regulatory oversight continues, but could be a good thing for asset managers

The regulatory landscape as we find it now is a result of the New Asset Management Rules introduced in 2018. As the grace period of the new rules came to an end in 2021 year-end, the industry entered a new era in 2022. But it is not a time when regulators dialed back the oversight on the industry. On the contrary, the new focus seems to be normalizing the measures introduced over the years so that various checking mechanism can be embedded into the business as usual without busting managers' cost structure or stifling their business development effort.

Table 2: Recent regulatory development

Date	Policy/ guidance
Apr 2018	The Guiding Opinions on Regulating the Asset Management Business of Financial Institutions
Sep 2018	Measures for the Supervision and Administration of the Wealth Management Business of Commercial Banks
Dec 2018	Measures for the Administration of Wealth Management Subsidiary Companies of Commercial Banks
May 2020	Interim Measures for the Administration of Insurance Asset Management Products
Jul 2020	Rules on Determining Standardized Credit Assets
Sep 2020	Supporting Rules of the Interim Measures for the Administration of Insurance Asset Management Products
Dec 2020	Several Provisions on Strengthening the Regulation of Privately Offered Investment Funds
May 2021	Interim Measures for the Administration of Sales of Wealth Management Products of Wealth Management Companies
May 2022	Notice by the Ministry of Finance of Issuing the Provisions on Accounting Treatment Related to Asset Management Products
Aug 2022	Provisions on the Administration of Insurance Asset Management Companies
Jan 2023	Measures for the Administration of Private Equity Asset Management Business of Securities
Jan 2023	Futures Operating Institutions and Provisions on the Administration of Operation of Privately Offered Asset Management Plans of Securities and Futures Business Institutions
Mar 2023	Notice of the China Banking and Insurance Regulatory Commission on Regulating the Trust Business Classification of Trust Companies
Mar 2023	Measures for the Supervision and Administration of Futures Companies (Consultation Paper)

Sources: MOF, People's Bank of China, CBIRC, CSRC, EY Parthenon Analysis

Several recent developments suggest the regulators will likely keep a close eye on the industry. The first is that we continue to see new regulations addressing some of the backlogs faced by the industry, especially around issues like cybersecurity, client privacy, Common Reporting Standard (CRS) and the Foreign Account Tax Compliance Act (FATCA). Secondly, for the new, so-called super regulator, Financial Supervisory and Regulatory Administration, to dial down regulatory effort seems to defeat the purpose of creating it in the first place. And lastly, globally several banks have succumbed to the rising interest rate, and this should alarm Chinese regulators to be more cautious.

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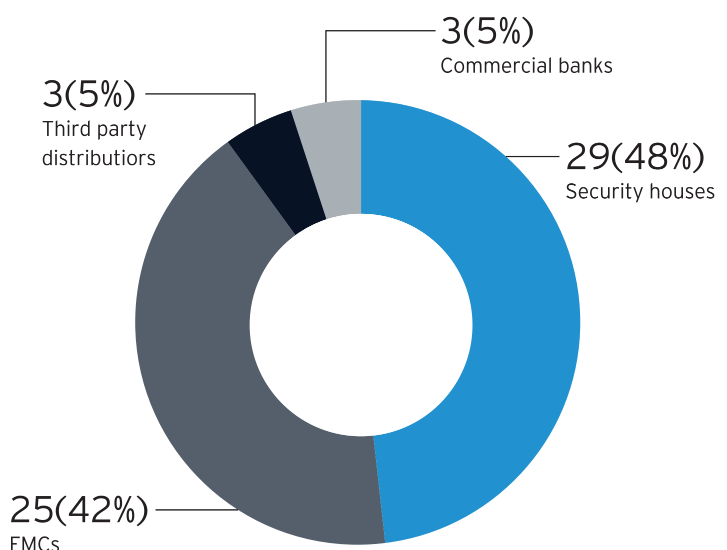
FIA offers new hope but requires immediate attention and investments

Fund Investment Advisor (FIA) is not exactly a new thing, as CSRC started to give out FIA licenses on a trial basis in as early as 2019. Over the years, more than 60 companies have been awarded such a license. While the business may have been flying under the radar, Chinese investors' need for professional advice has been growing as the product universe keeps expanding and becomes more complex.

We view FIA business as a critical complement to the mass distribution model currently employed by fund managers. Chinese HNWI investors have preferred a boutique model to a supermarket one when it comes to buying investment products. It stands to reason that as investor sophistication advances and average revenue per user increases, mass affluent and retail investors will go through a similar shift, as what has already been observed in almost all other retail industries in China.

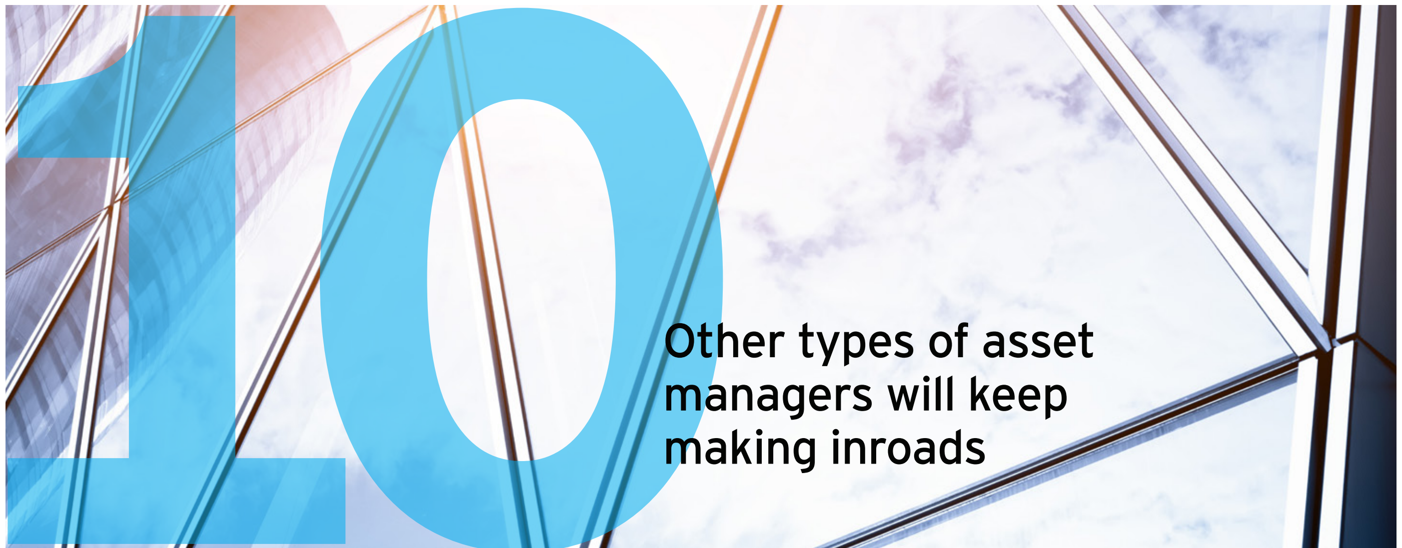
With the introduction of the private pension scheme, the value of professional investment advice is amplified, as Chinese retail investors face extra challenges to select long-term, illiquid and personalized investment products. The business is also boosted by increasing adoption of its revenue model: paid subscription is so much better received now compared with 2019 thanks to the progress made by technology industry.

Chart 7: FIA license holders by type of institution (#, %, 2022)



Sources: CSRC, EY Parthenon Analysis

Despite the long-term promises, the business will remain sub-scale for the near future and managers that are determined to entrench across the whole value chain should be prepared to commit to a long-term investment plan.



Other types of asset managers will keep making inroads

While FMC and Private Fund Manager (PFM) remain the core of China's asset management industry and have been performing well under the auspices of regulatory endorsement despite vicissitudes, some other managers have been pressing claims and will continue to do so. Among them, wealth management companies (WMCs) are probably the most formidable ones. Although technically not an asset manager, WMC s are licensed to conduct asset management business in addition to wealth management and investment advisory business. Most of the products manufactured in-house by WMCs are like mutual fund products with some legacy features of the pre-2018 banking wealth management products, e.g., can only be bought for a short period of time, low-risk, invest in bond, have a closed-end period, and a pre-designated maturity date.

This hybrid model allows the WMCs to leverage their endowment and perform their regulatory mission. And for the time being, both WMCs and their clients seem to be happy with this arrangement. As the transition period of the new asset management rules comes to an end, however, some WMCs have started to look for new business model and to expand into more serious product manufacturing by teaming up with a third-party asset manager, usually in the form of a joint venture subsidiary with a (foreign) pureplay asset manager.

In the long term, we expect all WMCs to acquire at least some asset management capabilities and thus become a competitor to asset managers like FMC and PFMs. How quickly this happens and how likely a showdown happens, if at all, depend on to what extent wealth management and asset management can remain distinct from each other from clients' and regulators' perspective. The initial attempts abovementioned by the more progressive WMCs have seen mixed results and suggest that most WMCs will listen more to the dictates of prudence than ambition.

The other group to watch for is securities firms. While their channel business continues to dwindle, more and more securities firms are making inroads to proper asset management business. Collectively they are already managing CNY600 billion AUM of separate account business and CNY60 billion AUM of mutual funds at 2022 year-end. Securities companies have various assets in research, trading and investment banking area that can be leveraged to support their asset management ambition. They also have an established distribution network on a national scale, as well as a decent client base. As they finish dealing with their legacy asset under management, we expect to see more securities firms to assert themselves as a contender in the asset management industry.

Most of the development in 2022 felt like a carryover of the changes started in 2018. But 2022 also saw these developments obtaining new dimensions. The eruptive growth between 2013 and 2018 and the vertical plunge since 2018 now feel almost like a massive hangover. Different sectors of the industry came out of the cycle at different speed but now they all have to embark on a new journey. When compliance and prudence are accepted as an ideal that transcends the industry, managers will gain a new perspective of investors, competition, technology, and not to mention, regulation itself.

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