ADVISORY SERIES

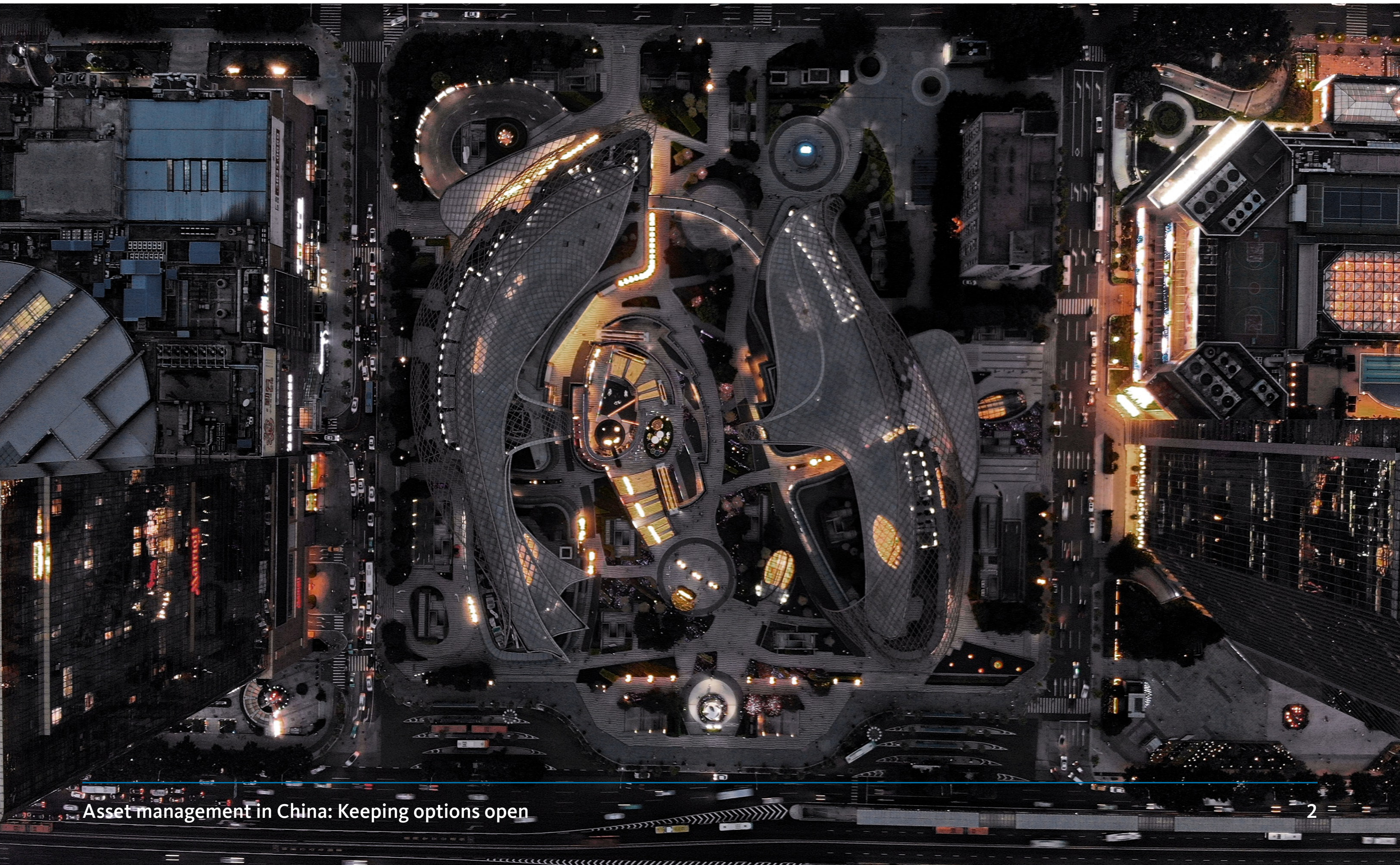
Broadridge®

Asset management in China:
Keeping options open

February 2022

Ready for Next

CONTENTS



ABOUT THE AUTHORS

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Principal

Based in Singapore, Yoon is one of the leading members of Broadridge's Advisory practice, which combines our market-leading analytics and insights capabilities to help our clients capitalize on emerging strategic opportunities across Asia Pacific.

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Bryan is our lead commentator for China, having advised and consulted numerous global asset management firms for over 15 years. He has assisted international asset managers in various areas, from market entry strategies, product and distribution development, and regulatory impact assessment to fintech innovation and implementation across Asia. He is a native Mandarin speaker, also fluent in English and German.

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Ben has helped leaders of asset management and wealth management firms on six continents improve their competitive positioning and financial performance for more than 25 years, most recently prior to Broadridge as a Principal and Chief Strategist for Casey Quirk, a Deloitte business, but also as an investment banker and analyst. He has authored and co-authored thought leadership outlining the evolving global investment advice industry. He speaks at major industry conferences and is often quoted in media including The Wall Street Journal, the Financial Times, Bloomberg, and CNBC.

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OVERVIEW

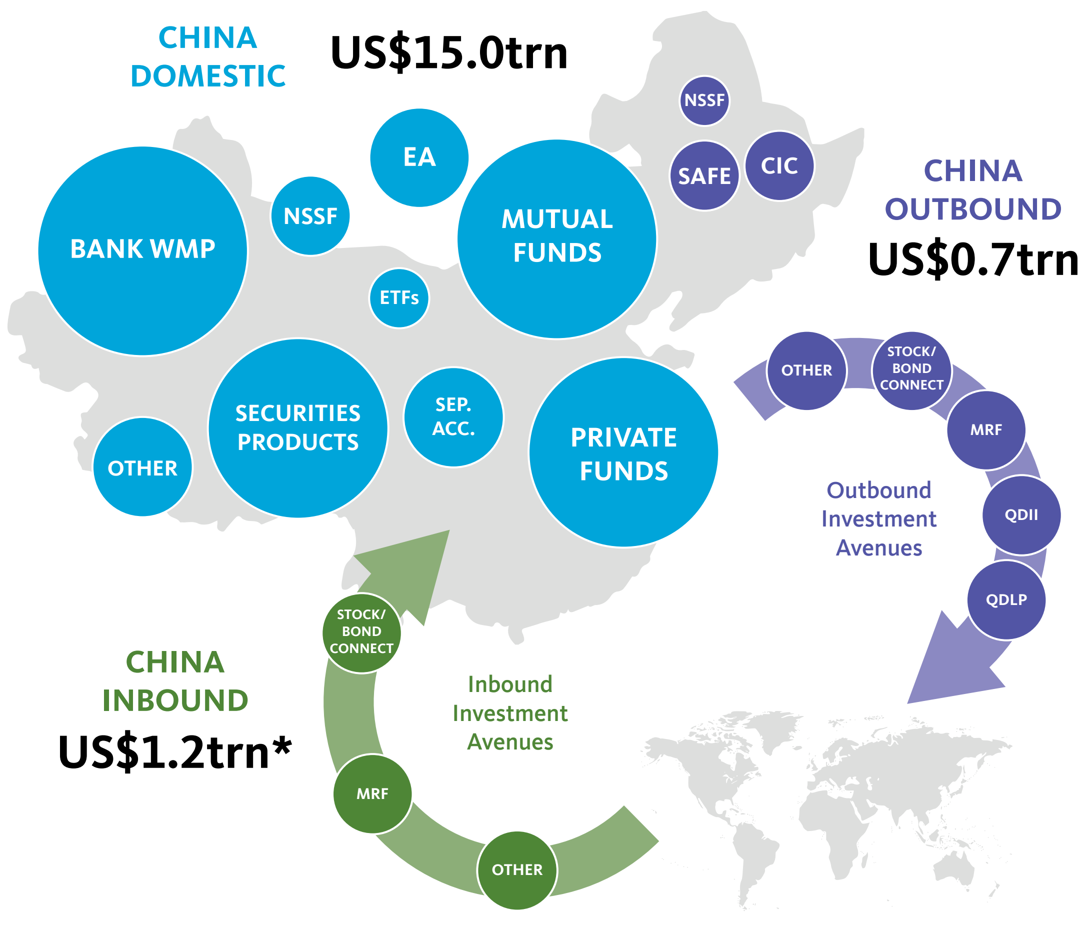
Despite persistent headwinds including the Covid-19 pandemic and geopolitical tensions, China's asset management industry remains too big to ignore for global managers.

China's surging asset management industry

The asset management industry in China has grown to a size that has attracted the attention of many global asset managers. Broadridge estimates the country's vast trifurcated asset management industry soared to almost US$17trn[1] in total assets under management (AUM) — as of H1 2021 achieving a CAGR of 16% over the last five years. Over the next five years to 2026, we expect China AUM to exceed US$32trn, consolidating its position as the second largest asset management industry in the world.

The lion's share is attributed to the domestic sector, which grew at a CAGR of 15% from 2015 to H1 2021. Outbound and inbound flows, while still a smaller proportion of total AUM in China, have displayed similar growth — at 11% and 32% respectively over the same period — highlighting their rising importance to the developing asset management market.

Total China Assets Under Management, 2021



Source: Broadridge China Navigator, Broadridge GMI Note: Data as of Q2 2021.
*Figure takes into account foreign holdings of Chinese equities and fixed income as of Q2 2021. Do note not all assets will be addressable to managers. We currently size inbound Chinese funds and ETFs to be worth around US$0.2trn.

[1] https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=CN

The drivers of growth

There are four primary drivers behind this growth story:

1. **Wealth creation**: The asset management industry's growth is an extension of China's impressive economic growth and subsequent wealth creation over the past five to 10 years. That wealth creation has fostered a boom in the size of China's middle class.

2. **Financialization**: This is driven by the growing financial literacy of retail investors, and supported by a greater number of tech-savvy millennials leveraging digital platforms and professional asset management services.

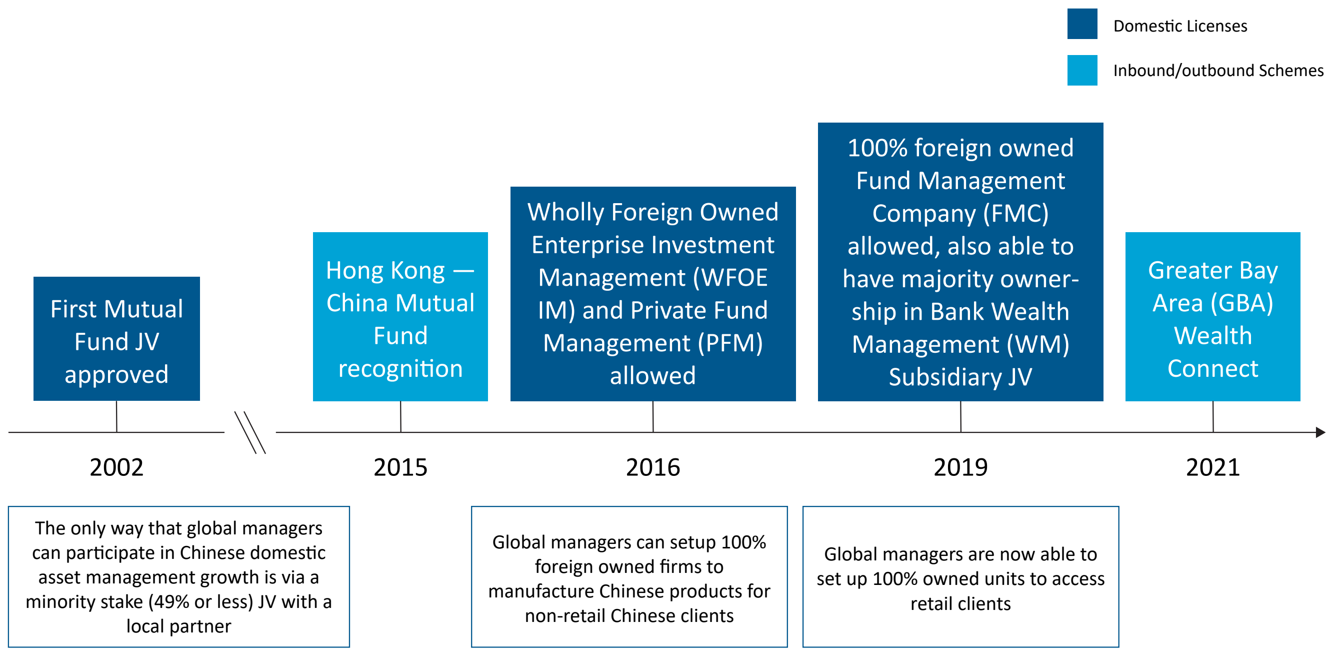
3. **Regulation**: Clampdowns on the shadow banking system have also encouraged the financialization of savings. Capital flows have been noticeably into three areas: Mutual funds, private funds, and bank wealth management products.

4. **Liberalization**: Reforms in recent years have encouraged a series of regulatory innovations to progressively open the market up to international capital and foreign financial institutions.

Business plans need to be fluid and adapt to new developments

Optionality is key to thriving in a dynamic environment like China. It requires one to have a flexible mindset, scalable operations and elasticity to evolving investor and regulatory demands.

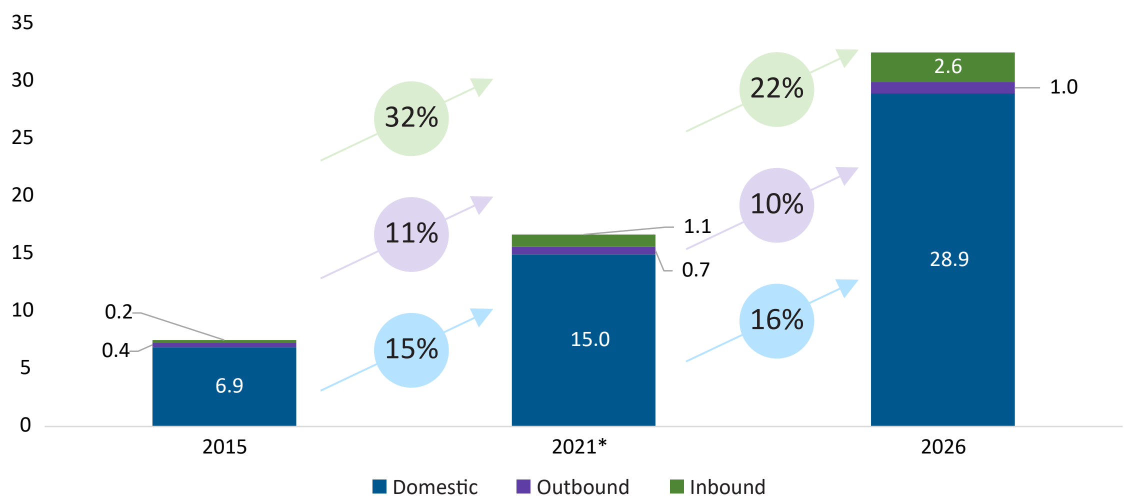
Regulatory reforms like these will continue to formalize and liberalize the asset management industry, delivering better access, consumer confidence, and product innovation to the market.



Future opportunities abound

The four primary growth drivers will likely continue to bear fruit in the coming years. Broadridge forecasts China's total AUM could climb to more than US$32trn by 2026. In CAGR terms, China's outbound and inbound investment segments are forecast to grow 10% and 22% respectively over the next five years, while the domestic segment is estimated to grow 16% over this period. Among investment products, exchange traded funds (ETFs) are expected to grow significantly in the domestic, inbound, and outbound segments.

Forecast of China asset growth



Note: *Data taken as of Q2 2021 or latest available.

Over the longer term, new investment themes and structural dynamics will play a larger role in China's development. One of the notable trends is ESG considerations in investment decision making. Globally, ESG investments are on track to grow from US$8trn today to as much as US$30trn by 2030, according to Broadridge's recent ESG and sustainable investment outlook report.

Similarly, as China steps up its net zero ambition[2], our research highlights ESG fund assets in China have more than tripled in 2020 alone to reach US$26.4bn, with clean energy accounting for 70% of total AUM. Starting from such a low base there is ample room for the industry to make significant headway into this space.

However, it should be noted that financial product innovation still has a long way to go in China, with the sophistication of financial solutions on offer generally lagging behind those of western counterparts. For example, bank wealth management products are still largely dominated by simple cash management and fixed-income offerings over a more holistic investment management platform. Even the adoption of low-cost model portfolios, an integral part of the US registered investment advisory (RIA) market, is a nascent part of the picture in China as are pension solutions.

Taken together, the picture seems particularly bright for global asset managers targeting the market. Technological innovation and a rapidly-aging population are spurring renewed interest in establishing a world-leading, digitally-enabled, financial services ecosystem. For global asset managers, this is opening new possibilities for customer acquisition and cross-border knowledge transfer for product innovation — backed by expertise and scale to carve out a potentially defensible competitive advantage.

[2] https://racetozero.unfccc.int/chinas-net-zero-future/

THE CHALLENGES FACING GLOBAL ASSET MANAGERS

There is no shortage of opportunities in China, but tapping this growth can prove elusive for global asset managers simply looking to build on home market success.

Four standout characteristics

The substantial growth of China's asset management industry has brought with it rising operational complexity, the deepening sophistication of domestic competition, and significant technological innovation — all at a pace unlike more mature western economies. This means that while the potential benefits to expansion are booming, so too are the risks that need to be properly managed.

We see four major characteristics that define China's asset management industry, setting it apart from developed markets. These are:

1. **China is run 'top down':** History has shown that regulations in China can change quickly, and in many cases, without warning. Decisions are readily translated into cascading policy action within any industry, making it a major driving force for the structure of the financial sector in ways unlike other markets around the world.

2. **Regulatory policy is not 'black and white':** The regulations governing China's asset management industry are, in many areas, still being established or not yet fully defined, leading to operational 'gray areas' for asset managers. This means that while there is significant room for innovation and creativity across the market, where rules are comparatively lax, there is also notable risk that this freedom could quickly be restrained should it be deemed necessary.

3. **Earlier stage of development:** China's asset management growth story is in its early days of development. The rewards on offer for global firms are significant from both an asset gathering and revenue standpoint. Amid slowing industry growth and compressed margins in the US and Europe, this is a very attractive proposition for the bold and nimble.

4. **Democratization of savings and digitalization:** As mentioned, China's surging middle class has pivoted readily to the utilization of financial assets, unlocking a pool of one of the world's most prudent savers to the professional asset management industry.[3] The broad adoption of digital technologies by Chinese consumers has largely outpaced their counterparts globally.[4] Taken together, the market is characterized by a dominant retail investor segment that tends to be more volatile than the institutionally driven US and European markets.

Rethinking traditional growth strategies for optionality

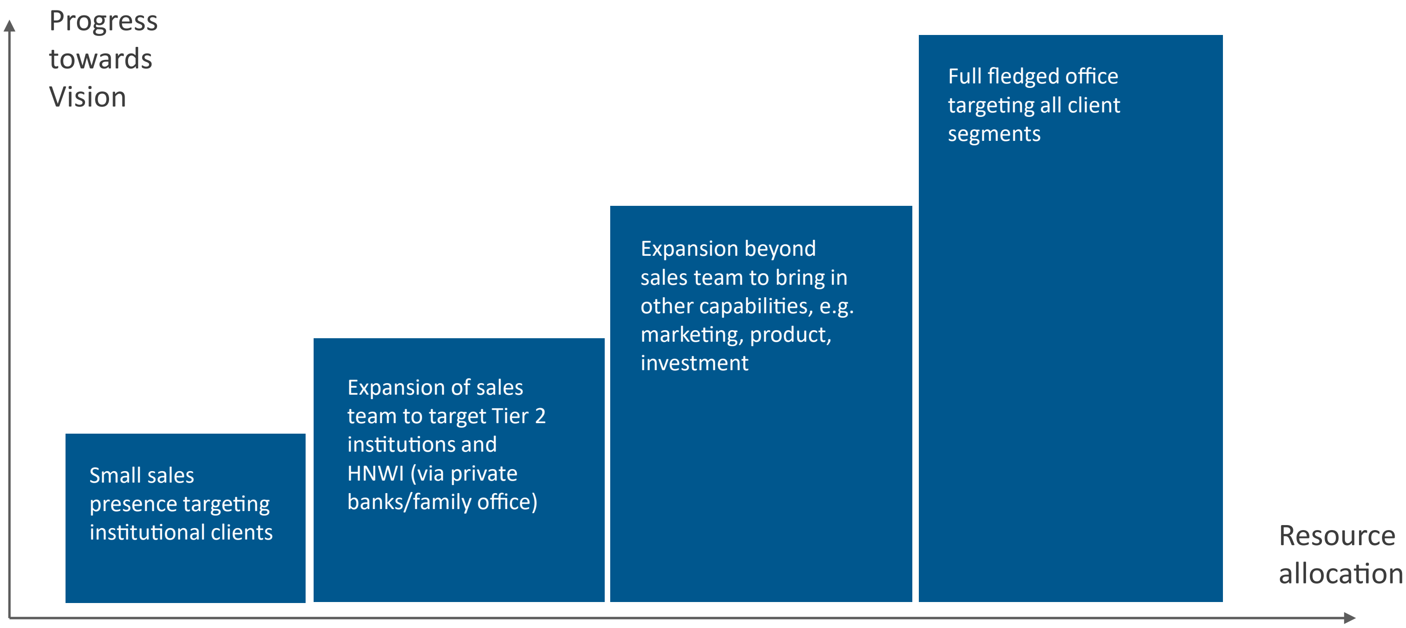
For firms looking to tap China's flourishing financial services market, China's dynamic and policy-driven environment makes it unique compared to its more developed peers. This uniqueness necessitates a fundamental shift in mindset when formulating a strategic approach to accessing opportunities in the country.

The ways that a foreign firm may have found success back home may not lead to the same result in China. Traditionally, the 'staircase model' to business expansion, which builds off a core base of institutional clients and ladders up to capture the broader retail segment, has been the standard approach for global managers in developed markets. Many well-established global players like BlackRock and Fidelity have leveraged this roadmap to great success in the US and Europe.

[3] https://www.ceicdata.com/en/indicator/china/gross-savings-rate

[4] https://home.kpmg/cn/en/home/news-media/press-releases/2018/11/china-consumers-lead-in-adopting-technology-finds-kpmg-survey.html

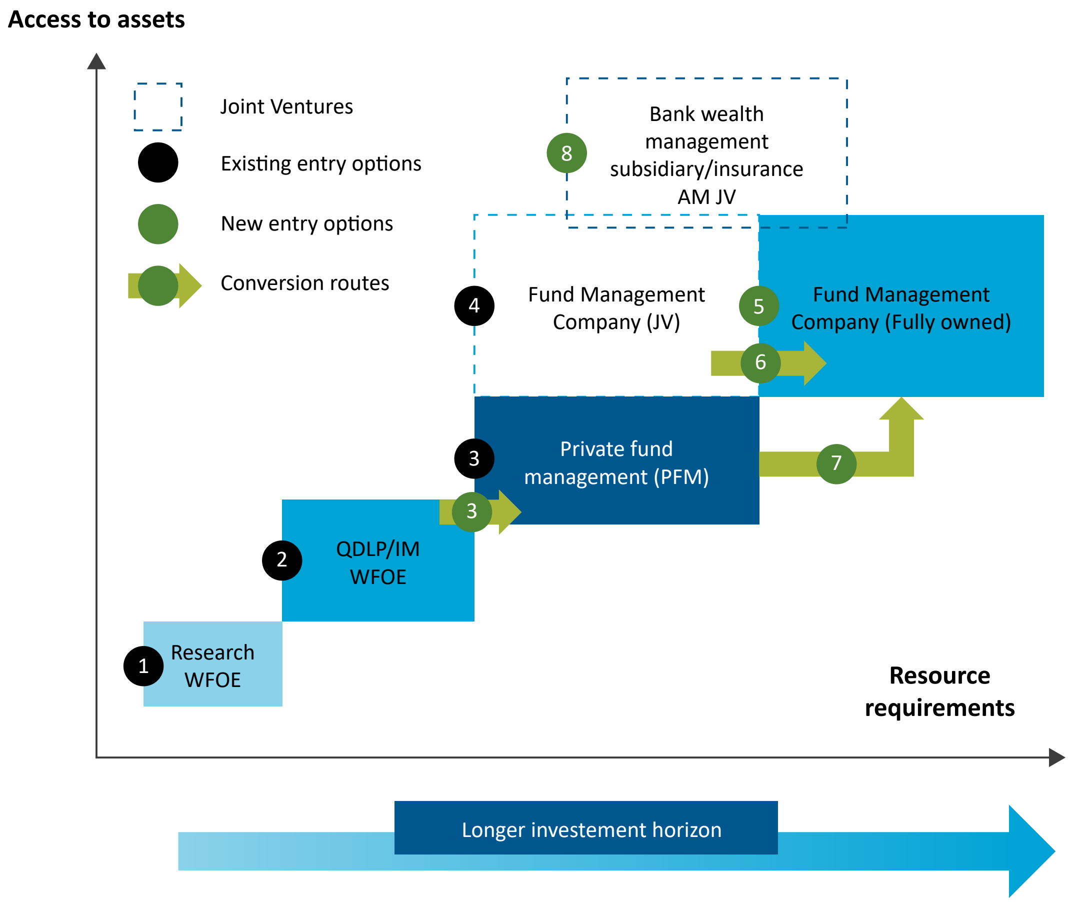
The traditional staircase model



Keeping pace with the fast-moving nature of the domestic asset management industry requires a rethink of this traditional growth strategy toward approaches that embrace **optionality** and **flexibility** in a way that recognizes cultural nuances in order to thrive. Business plans need to be fluid and adapt readily to new developments to effectively capitalize on tailwinds and weather headwinds.

Furthermore, despite concerted steps to continue liberalizing the financial services industry, accessing this US$17trn trifurcated market (domestic, outbound, and inbound) is not a straightforward process. An overlapping web of changing license and quota requirements still needs to be navigated carefully depending on the business being carried out.

A myriad of ways to access China



On the bright side, there are more entry and distribution options available to global asset managers seeking channels to access the China market than ever before. Each differs in its level of risk but also in potential reward. As AUM continues to soar, sitting on the sidelines will become less of a viable option and firms will need to proactively assess these routes to market, as well as the potential opportunities they offer their global business portfolio.

The complexities of expansion are very real but recognizing the important role **optionality** plays in strategy design will make the difference between success and failure.

WHAT CAN WE LEARN FROM THE WINNERS?

Over the years foreign fund managers have had time to adapt and some have come out on top, providing valuable insights on the winning approaches to growth.

No 'one-size-fits-all' model

Broadridge constantly monitors China's evolving asset management landscape. This includes continually tracking 75 leading asset managers operating in China with a combined global AUM of more than US$64trn. Our team of experts updates this list of managers taking into consideration any new firms that have a budding China business strategy — be it in the domestic, outbound, or inbound opportunity bucket. With our finger on the pulse of regulatory trends, competitive dynamics, and technology, we have developed a deep understanding of winning traits leveraged by market leaders.

One major takeaway from our research effort is that there is no 'one-size-fits-all' model to success. Our latest China Power Ranking H2 2021 clearly shows that it takes much more than absolute size to come out on top. In fact, asset management leaders score well across six primary criteria, namely:

1) Size of China AUM

2) Extent of business scope

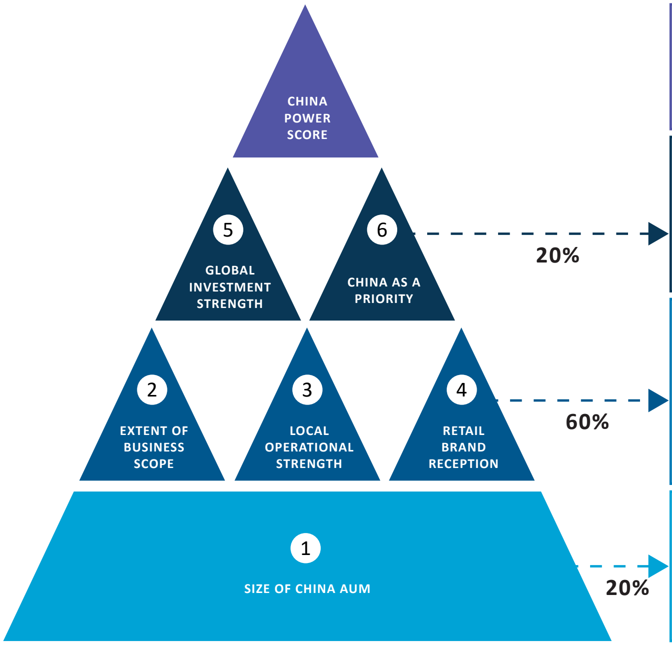
3) Local operational strength

4) Retail brand Perception

5) Global investment strength

6) China as a priority

China Power Ranking — success criteria



China power score
Scores across all six criteria are tallied to determine the foreign manager best positioned for success.

Long term commitment and resources
We take into consideration the global AUM of the firm as it will impact the ability to commit resources, as well as the breadth of business. We also give a quality assessment of China as a priority for firms, as it takes commitment to succeed.

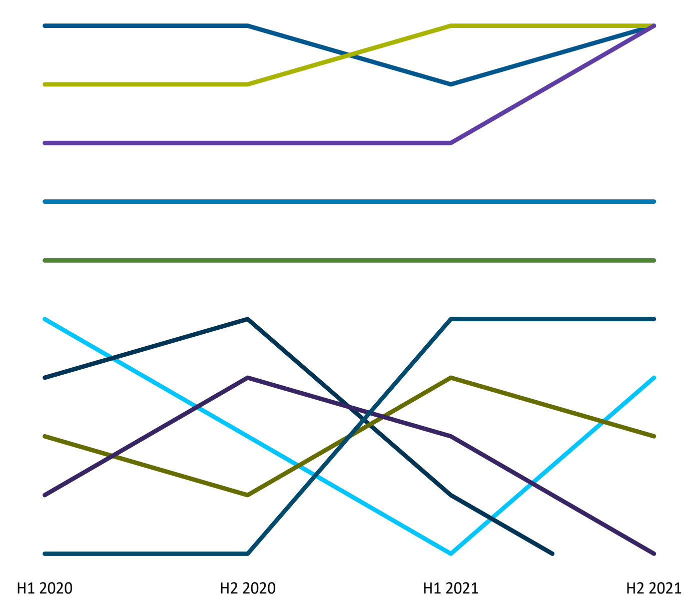
Near term capabilities and track record
Having a well established and diversified domestic operation, balanced with a range of inbound and outbound businesses/quotas, will hold managers in good stead to adapt to the fast-changing regulatory environment. Taken into consideration are the latest local commitments such as FMC approvals/applications and setting up new JVs.

Current asset gathering
To account for the size of total China AUM, we look at assets across three opportunity sets: domestic (Chinese assets for Chinese clients), inbound (Chinese assets managed for offshore clients) and outbound (offshore assets managed for Chinese clients).

While size is important, it is not the only factor we consider. We also consider our six key criteria across three different time horizons — current, near, and long term.

Looking at the top 20 global managers in our latest ranking, we see a tight three-way tie between notable behemoths **UBS Global AM, JP Morgan AM**, and **BlackRock**. Each firm, however, has a different business profile and focus from the others. More generally, managers with the highest scores boast solid brand recognition among investors, are equipped with a comprehensive set of licenses and quotas, robust local operational strength, and have strong commitment from global executive committee.

Competitive positioning — China Power Ranking

Rank H1 2020	Manager	China Power Ranking (Bi-annual)	Manager	Rank H2 2021
1	UBS Global AM		UBS Global AM, JP Morgan AM, BlackRock	1
2	JP Morgan AM			
3	BlackRock			
4	Invesco		Invesco	4
5	Schroders		Schroders	5
6	Fidelity		Allianz Global Investors	6
7	AXA IM		Fidelity	7
8	DWS		DWS	8
9	Eastspring/Prudential plc		Amundi	9
10	Allianz Global Investors		Eastspring/Prudential plc	10

This table shows the competitive landscape among foreign managers. However, domestic managers make up an increasing proportion of the competition.

Source: Broadridge FBF Intelligence 2021 Data.

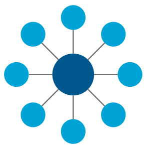
While the list above competitively ranks global managers, the race for market supremacy will increasingly be against domestic managers and not just foreign peers. For these local players, China is their priority. Many are becoming significantly larger, more sophisticated, and have deep penetration in both retail and institutional segments — all the right ingredients for a formidable peer.

Unlocking optionality: five fluid growth models

Our observations over the years have shown that global fund managers tend to adopt one of five growth models when establishing a presence in the world's second-largest economy. The models differ with regard to the level of resource and organizational commitment, their inherent risks, and obviously their potential reward. Broadridge has compiled and summarized the five business models below showcasing their different strategic approaches and characteristics. It is important to note that these business models are not static. They are fluid, and firms can shift from one model to another or adopt a blend of characteristics. It is this embedded **optionality** that makes their implementation potentially so successful. Firms are better able to shift their approach to capture new opportunities, respond to competitive threats, manage regulatory risks, and — most importantly — grow in a manner that is purpose-built for China's dynamic market and a firm's unique needs.

Five growth models for global managers in China

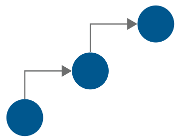
All access model



Embraces an all-options approach to maximize asset gathering potential

Notable examples:
- BlackRock
- JP Morgan AM

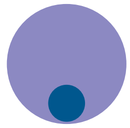
Incremental model



Takes a focused step-by-step approach to growing assets

Notable examples:
- Fidelity
- Neuberger Berman

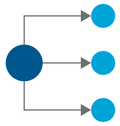
Leverage model



Leverages on parent group to guide expansion strategies

Notable examples:
- HSBC Global AM
- UBS Global AM

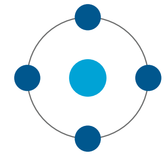
Collaborate model



Largely uses a JV or minority stake model for asset growth

Notable examples:
- Amundi AM
- DWS

Remote model



Does not commit to a full-fledged domestic presence, focused on outbound and inbound opportunities

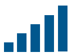
Notable examples:
- BNY Mellon Investment Management
- T Rowe Price

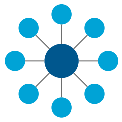
We have outlined five key business models that characterize the access strategy global managers take to grow their position in the Chinese market. However, these business models are fluid, and firms can shift from one model to another or use aspects of different models.

Striking a delicate balance between risk and reward

Each of the five growth models requires different levels of investment, time, and commitment. The inherent levels of risk and complexity within each approach to expansion can differ markedly. The following are generally ranked from highest level of potential risk/reward to lowest:

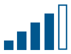
1. **All Access model** — Highest risk/reward

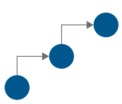




Managers in this group embrace an all-options approach to maximize asset gathering potential, typically possessing all FMC licenses as well as a majority-owned wealth management (WM) subsidiary JV. This 'growth-at-all-costs' approach comes with large upfront resource costs and significant time commitment to implement. These firms will leverage both organic and inorganic growth options through enhancing internal capabilities and building a large local presence, as well as acquiring peers and forming JVs.

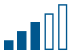
2. **Incremental model** — High risk/reward

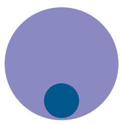




In this case, a firm will lean progressively towards the 100% FMC model, taking a step-by-step approach to grow its total AUM. The focus is on identifying key client segments, distribution models or product strategies, with the tendency to focus on one channel before progressing to the next. Resource commitment is measured and controlled, with a moderately-sized local team. Firms in this group typically start with a wholly foreign-owned enterprise (WFOE) or private fund management (PFM) license before moving to a 100% FMC license.

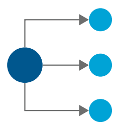
3. **Leverage model** — Moderate risk/reward





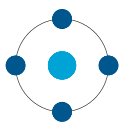
Asset managers in this group leverage the strength of their parent group to guide their expansion strategies. They prefer a rounded asset growth strategy from core, complementary to exploratory approaches, targeting entire client segments. Organic growth typically takes precedence over inorganic options, but these are not entirely ruled out and acquisitions of controlling stakes are still viable. Costs tend to be moderate.

4. Collaborator model — Low to moderate risk/reward



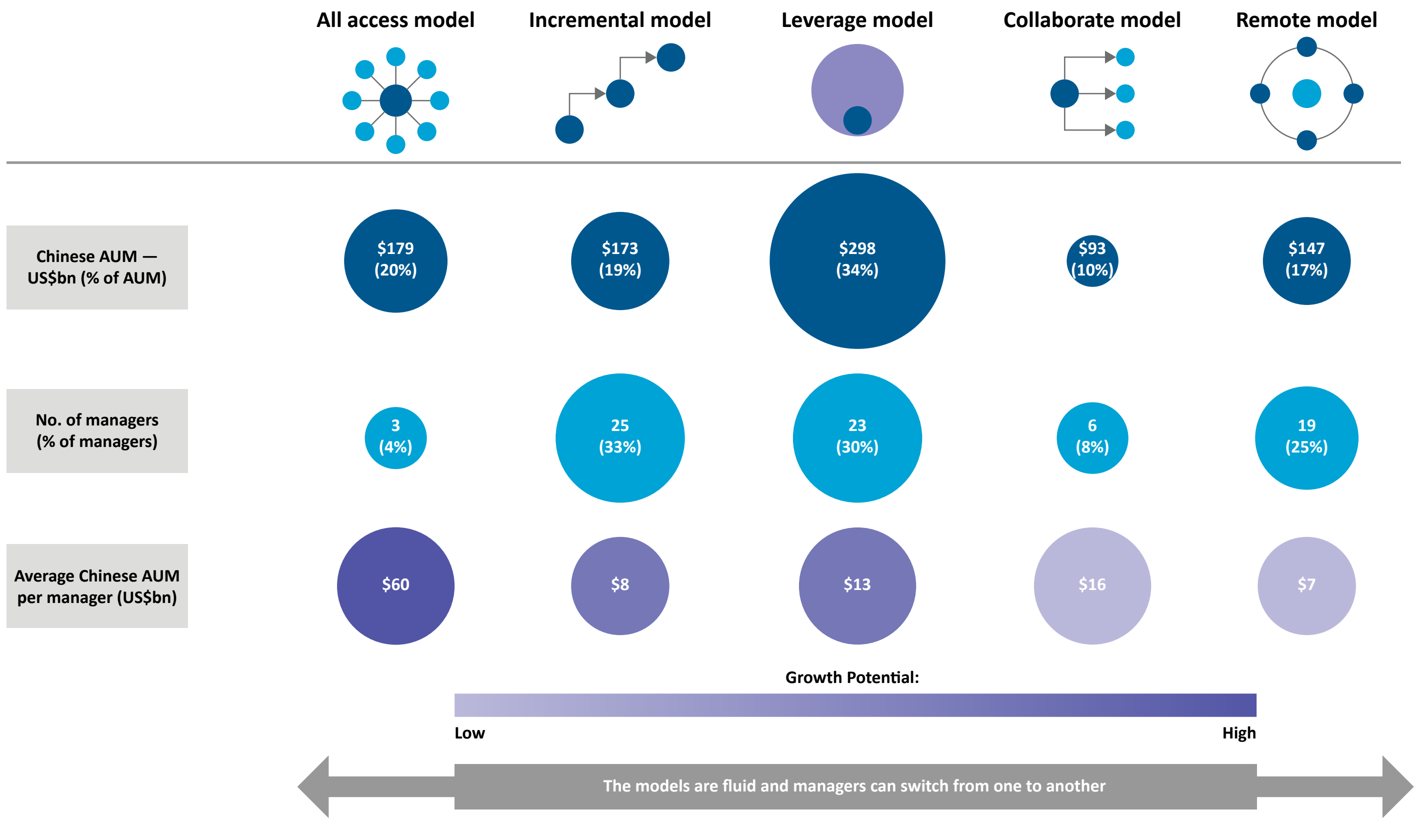
Global managers in this category have no 100%-owned FMC or PFM operations. Expansion is focused on the utilization of JVs or minority stake investments. Spending on organic growth is fairly limited compared to the other models. These players also tend to diversify their growth approach across various client segments, leaning on a breadth of capabilities and access channels.

5. Remote model — Low risk/reward



A more arms-length growth model than the others in this list. Adopting this strategy largely means a fund manager has not committed to any fully-fledged domestic presence. Instead, they have chosen to take a more exploratory approach to learn more about the market, rather than setting asset-gathering targets. These firms typically focus on servicing cross-border outbound and inbound investment flow opportunities over the domestic retail market. Resource spend is controlled to a minimum, supporting a very small local team in most cases. We also note that some managers consciously tout their lack of domestic presence as a sign of greater independence and freedom in research and operations.

Size of the potential rewards



You will need to survey the addressable market and decide what model best suits your firm. The returns are potentially higher when the stakes/risks are higher.

While it is crucial to consider the risks present in each of the five growth models, it is equally important to put them in the context of the potential rewards. It is a critical examination of the risk/reward trade-off that must inform a decision about the strategic approach. As you can see from the diagram below, the level of competition within each model and the available AUM growth varies significantly.

The 'all access' and 'leverage' models make up a notable proportion (54%) of Chinese AUM, but only a minority (34%) of the players. More importantly, perhaps, is the higher growth potential of average Chinese AUM per manager compared to other strategies in the future. These results make sense given the significant barrier to entry both strategies entail.

Comparatively higher costs, regulatory hurdles, resource commitments, and local brand building contribute to a relatively more defensible market positioning in China's booming asset management space. On the other hand, the safer, more arms-length 'remote' and 'collaborator' models could contribute to a more subdued growth trajectory. Generally, the higher the risk and commitment taken the greater the reward.

In addition, risks and rewards should also be viewed **holistically** rather than in silos. There is potential to unlock synergies across business units that can increase chances of success.

PUTTING STRATEGIC DESIGN INTO PRACTICE

The prospect of incorporating China's risk and opportunity landscape into a viable operating model may seem daunting — but it doesn't have to be with a systematic approach.

Defining what success looks like

China is a land of opportunities but the road to success is fraught with failures. Deciding on a growth model that fits the needs of your business can seem daunting, and choosing where to begin almost paralyzing. But a good starting point is defining what success looks like. In our experience, expansion plans into China fail because a firm is not sure what they want to achieve in the market. Without establishing this as a 'true north' at the outset there is little hope in succeeding over the long term.

There are many ways of defining success in China, but ultimately it is important for this definition to be aligned with realistic business goals. There are three primary business goals that we hear repeatedly across the industry as defining success for global asset managers. Each serves a guiding point for what the business is hoping to achieve and has a direct bearing on the way a firm will approach opportunities, risks and growth. They are:

- **Maximize AUM growth:** Enter China with the goal to expand total AUM and capture a growing share of assets domestically.
- **Maximize profit growth:** View China as a source of revenue growth and boost profit margins in business portfolio.
- **Business diversification:** Position China as an opportunity to improve diversification of business portfolio and achieve tangential growth.

Designing a successful China strategy — what should I do?

Business goals: Defining Success	Key considerations when designing your China Strategy: Opportunities in China	Key considerations when designing your China Strategy: Risks in China
Maximize AUM growth China is one of the largest and fastest growing AM opportunities	• Should I rely on organic or inorganic growth approach? • Am I looking for it to be a key significant part of overall AUM or is there no hard asset target?	• How much do I understand the M%A landscape in China? • What are the risks to my existing business if the M%A/partnership fails? • What is my investment horizon? Am I able to invest for >10 years before seeing results?
Maximize profit growth Domestic managers are witnessing doubling of profits YOY	• Should I be focused on one access point/ license, or should I diversify my business? • Who can I leverage on for China growth, both internally as well as externally?	• Will my cost approach be growth at all cost or a more measured aproach aligned to growth targets? • How does my desired growth model align with leadership plans and firm culture? • Do I have the right team and products to operate locally?
Business diversification China can achieve tangential growth to other global markets	• How does it fit into my existing business model? Are there opportunities for Chinese fund sales to global investors and vice versa? • Can I achieve brand leverage with this expansion move?	• What are the other potential risks to my business? Eg. Gepolotical, reputational, data disclosure? • To what extent can it help diversify my existing clientele/ market and product mix vs. diverting resources away from existing developments?

There are many ways of defining success and it is important to have clear goals. There are also significant costs and benefits attached to each decision that must be assessed.

What is a ‘good’ strategy?

There are a few criteria that differentiate a ‘good’ strategy from a ‘bad’ one. First, the strategy must be **‘built to suit’.** This is required if a strategy hopes to gain sustained group buy-in and support for implementation, especially in a fast growing market like China where changes are frequent and often costly.

Second, it must be **realistic.** There should be clear acknowledgment of the firm’s strengths and weaknesses: in particular the challenges of building brand awareness in China where global brand recognition is low. Lastly, it must empower **optionality** within firms to effectively capture existing opportunities, while at the same time affording flexibility to **capitalize on what’s next.**

Once a strategy is implemented it takes long-term commitment to see it through. Too many firms expect this entire process to be an overnight success. The truth is the goal posts are constantly moving — but the rewards get that much sweeter too. Many global asset managers will find that the more successful they are in China, the more resources they need to put into cultivating the venture, in order to take it further.

Leveraging market leading data, analytics, and advisory

Throughout this entire process and in support of any long-term strategic commitment, it helps to have a trusted partner by your side that is plugged in to the market and understands the changing needs of the environment. No matter the level of ambition you have in China, critical to this endeavor is a robust roadmap forward backed by data, analytics, and advisory expertise to make well-informed decisions. The industry moves fast, and you need to move faster.

At Broadridge we empower our clients to become market leaders and take advantage of emerging trends. Our unparalleled integrated offering of leading global data analytics capabilities, allows us to provide trusted advice and decision support to the C-suite. Broadridge is at the forefront of innovation, looking at new ways to disrupt the traditional consulting approach with a more data-driven diagnostic process. We deliver impact by helping clients monitor their progress against strategic and change management goals on a regular and timely basis.

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