Asset Management Industry Development in Hong Kong, Singapore and China

by

Terence Chong
Vivian Wong

Working Paper No. 7

March 2012

Institute of Global Economics and Finance
The Chinese University of Hong Kong
13/F, Cheng Yu Tung Building, 12 Chak Cheung Street, Shatin, Hong Kong

Acknowledgements

The Institute of Global Economics and Finance is grateful to the following individuals and organizations for their generous sponsorship:

Vincent H.C. Cheng

C.K. Chow

Victor K. Fung

Lawrence J. Lau

K.L. Wong

BCT Financial Limited

China Development Bank

Henderson Land Development Co. Ltd.

The Hongkong and Shanghai Banking Corporation Limited

Sun Hung Kai Properties Ltd.

Asset Management Industry Development in Hong Kong, Singapore and China

Terence Chong and Vivian Wong

1. Introduction

In the latest Global Financial Centres Index survey, Hong Kong and Singapore were ranked third and fourth respectively for its asset management industry for three consecutive years, while the top two places were occupied by London and New York. China is also a huge market for the asset management industry. However, due to the restrictions on foreign exchange and financial markets, foreign-funded asset management companies face difficulties in entering the Chinese market, while Chinese companies need approvals when investing overseas. Thus, in this paper, the analysis on the development of China's asset management industry focuses on domestic markets, while assessments of the Hong Kong and Singapore markets, which are completely open, are based on their potential in becoming regional hubs for asset management.

2. Market overview

According to the annual Fund Management Activities Survey conducted by the Securities and Futures Commission, the combined fund management business of Hong Kong was increased to HK$10 trillion (US$1.29 trillion) as of 2010. For asset management business, 67.6% of assets were funds from non-Hong Kong investors, while 60.8% of assets were managed in Hong Kong. As shown in figure 1, majority of the assets managed in Hong Kong were invested in Asia, accounting for around 80% of total, and of which more than 60% were invested in Hong Kong and the mainland. Also, Hong Kong has the largest hedge fund business in Asia. As of 2010, there were 538 hedge funds in Hong Kong with asset under management reached US$63 billion.

According to the annual survey of the Singapore asset management industry conducted by the Monetary Authority of Singapore, total assets managed by Singapore-based asset managers reached S$1.4 trillion (US$1.1 trillion) as of 2010. More than 80% of total assets were sourced from outside Singapore. As shown in figure 2, the key investment destination was in Asia Pacific, accounting for 64% of the total. Hedge fund business amounted to US$53 billion in 2010 and the number of hedge fund managers was increased to 392. For China, the size of asset under management in 2010 reported by the Securities Association of China was RMB2,900 billion (US$457 billion), of which 79% was in mutual funds.

Figure 1: Asset managed in Hong Kong by geographical distribution of investments

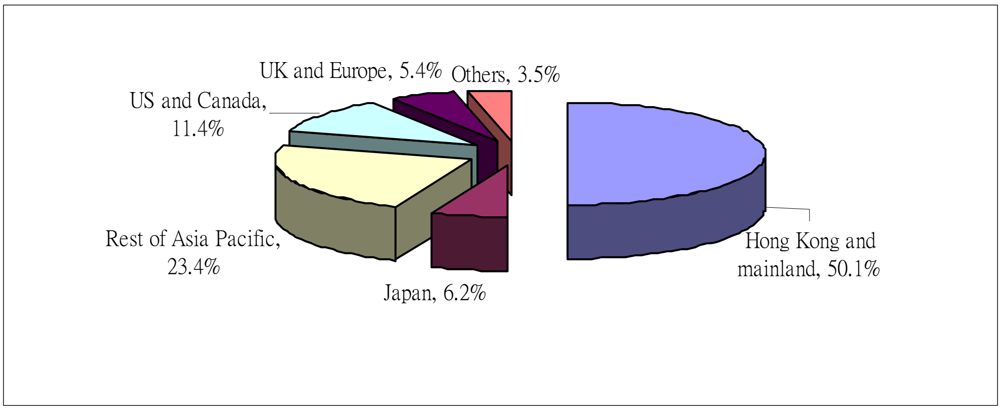
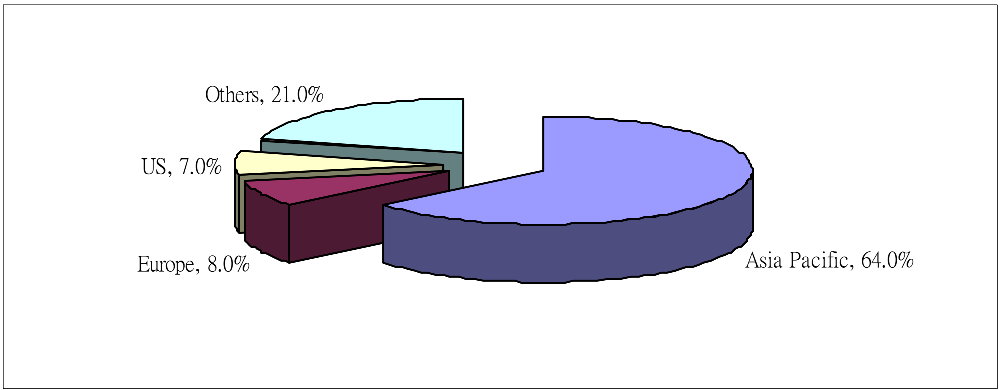


Figure 2: Geographical distribution of investments by Singapore-based asset managers



In a PricewaterhouseCoopers (PwC) report published in late-2010, it noted that Singapore would likely become the leading regional asset management centre in Asia, despite Hong Kong's advantage of having close proximity to China. The major reason is that the Singaporean Government has a clear target to become asset management centre in Asia, and is more proactive in promoting its asset management industry, thus Singapore has a higher existing value of asset under management than Hong Kong. In addition, Singapore will attract international investment from investors targeted at the nearby South East Asian countries due to its geographical advantage, while Hong Kong's asset management industry has to compete with other financial centres of

China, for the businesses inside and outside China.

3. Tax incentives and market restrictions

In terms of tax incentives, corporate tax rate for fund management companies is the lowest in Singapore at 10%, while it is 16.5% in Hong Kong and 25% in China. Although some fund management companies may incorporate in Cayman Islands and other offshore locations to enjoy the tax free benefit, it might not be recognized by some countries, such as China, where the companies have substantial operations there, and they may still required to pay local taxes. In order to enjoy lower corporate tax rates, some asset management companies with frontline staff handling investment businesses in China retain the “management and control” functions at their offices in Singapore or Hong Kong. For individual salaries tax, lower tax rates can attract talents of the industry to work in the country. Hong Kong charges at progressive tax rates depending on chargeable income, ranging from 2%-17%; Singapore also charges at progressive rates for residents, ranging from 0%-20%, but non-residents are charged at 15%, and director’s fees, consultation fees and all other income are taxed at 20%; and China’s individual salaries tax increases progressively with income from 5% to a maximum of 45% on monthly income over RMB100,000. There is no capital gain tax in Hong Kong and Singapore, but individuals are subject to 20% capital gain tax in China.

The Singapore Government is good at providing tax incentives to boost the development of the fund management industry. On top of the concessionary corporate tax rate, the offshore fund regime was also introduced. An offshore fund managed by a Singapore-based fund manager will be exempted from tax on specified types of income if the fund is a qualifying fund. Another similar scheme, Singapore Resident Fund Scheme, was introduced in 2006 for onshore funds with substantial economic substance in Singapore. In 2009, an Enhanced-Tier Fund Management Scheme has also been introduced for funds with a minimum size of S$50 million. For the period from 1 April 2009 to 31 March 2014, there will be fewer restrictions on tax exemption, such as, no restriction imposed on the residency requirement for the fund vehicles and that of investors.

Hong Kong introduced an offshore fund tax exemption scheme in 2006, and incorporated ten years of retroactivity period. According to the ordinance, non-resident funds without any transactions other than the specified business operations in Hong Kong will be exempted from tax. However, unlike offshore fund exemption scheme of Singapore, Hong Kong's exemption scheme does not allow ownership of private companies, and thus the setting up of private equity funds is more preferred in Singapore than in Hong Kong. Nevertheless, Hong Kong has the leading advantage of being the gateway for capital entering and leaving China. It is easier for management and employees to travel to and from China. Hong Kong also enjoys more advantages, such as entering the Chinese market under the Closer Economic Partnership Agreement (CEPA). Explicit support for the development of Hong Kong into an offshore renminbi (RMB) centre and an international asset management centre was given by the Chinese government in its Twelfth Five-year plan. Private equity and real estate funds prefer to exit their investment through an initial public offering in the Hong Kong stock market rather than in Singapore, because of the higher P/E ratio and market turnover in Hong Kong. In fact, the P/E ratio for the same stock is often the highest in the China stock market, but the waiting period for company listing is often longer that some companies will choose to list in Hong Kong instead.

Due to the relatively high corporate tax rate in China, fund management companies will choose to incorporate in China only if their investment targets are Chinese investments or their customers are Chinese investors. Sellers of Chinese assets often prefer selling their assets to pure RMB funds, as no waiting period is required for the realization of the sale, versus overseas funds in foreign currencies which are subject to foreign exchange control and require approval from the State Administration of Foreign Exchange (SAFE) to convert the foreign currencies into RMB before investment. Foreign-owned enterprises are allowed to take the role of fund managers for RMB funds. However, if the fund involves a foreign investor to become a qualified foreign limited partner (QFLP), the fund has to secure an investment project before it can convert foreign currency into RMB for investment. Furthermore, the fund will be subject to industry restrictions and approval will be required. China's hedge fund industry is at its infancy stage, with their first hedge fund being established in early 2011. Margin financing and short selling are still restricted to a limited number of stocks, while high-frequency trading is discouraged by regulators, making it hard for hedge funds to operate in the Chinese market. Also, programs to allow REITs were shelved as a result of the overheating of China's real estate market and the lack of regulatory and taxation framework for such trusts.

In order to further develop the asset management industry, Hong Kong and China should learn from Singapore in offering concessionary corporate tax rates and other tax incentives for the industry. China should also remove restrictions on foreign invested funds and companies in a controlled manner, for example, in January 2011 Shanghai declared the implementation of measures on the pilot program for foreign-invested equity investment enterprises, which addressed the issue of allowing a qualified pilot enterprise to use its own foreign currency, up to a maximum of 5% of total capital, to subscribe to a RMB fund that it establishes without affecting the original classification of the fund.

4. Market demand

Hong Kong's affluent population as a proportion of total population is the second highest in the Asia Pacific region and the number continues to rise. After the introduction of the mandatory provident fund scheme in 2000, there is an increasing demand for asset management services. Also, the Capital Investment Entrant Scheme which enables foreigners to become Hong Kong residents through capital investment of at least HK$6.5 million has brought in more than HK$50 billion in capital into Hong Kong since 2003. While China's asset management industry is still underdeveloped, it offers enormous opportunities for Hong Kong to serve the Chinese market through CEPA and the development of Hong Kong as an offshore RMB centre. As the pool of RMB in Hong Kong increases, more RMB-denominated financial products will be introduced by the industry, serving both the needs of international and domestic investors.

In Singapore, with the Central Provident Fund (CPF), a compulsory government-managed retirement savings scheme, a working individual contributes 20% of his salary to the scheme, while his employer contributes another 16%. The CPF scheme absorbs a large part of savings from the population. As of 2010, total assets owned by the Singapore CPF Board were US$144.8 billion, ranked as the 10th largest pension fund in the world. The government allocates part of this pool of money to some qualified asset management companies to manage and thus facilitates the development of the industry. Given strong government support for the industry and the presence of financial professionals in the city, the demand for asset management services is not generated by local citizens only, but also from the affluent populations in nearby Southeast Asian countries.

China has a growing demand for asset management expertise to manage savings from the emerging affluent middle-class population. According to a global wealth study conducted by Deloitte in 2011, it predicted the number of millionaire households in China would grow from 1.2 million to 2.5 million between 2011 and 2020, and the total wealth among millionaire households would be increased from US$1.67 trillion to US$8.24 trillion over the same period. Besides Shanghai and Beijing, Hangzhou, Wuhan, Chongqing, Chengdu and Fuzhou are also huge potential markets for the asset management industry. Further with the continued reform on pension system and the gradual liberalization of Qualified Domestic Institutional Investors (QDII) scheme and Qualified Foreign Institutional Investors (QFII) scheme, it certainly helps to boost the demand for asset management services both within and outside China.

5. Development of the industry

During a visit to Hong Kong in August 2011, China's Executive Vice-premier Li Keqiang announced new measures to enhance Hong Kong's status as an international financial centre, including the launch of an exchange-traded fund (ETF) constituted by Hong Kong-listed stocks in the mainland market and the introduction of the RMB Qualified Foreign Institutional Investors (RQFII) scheme to allow foreign investors to invest in RMB in the mainland market, which was launched since January 2012. Both schemes will benefit the asset management industry in Hong Kong.

On the other hand, Singapore intends to strengthen regulatory oversight over the fund management industry in this year. Fund management companies with more than S$250 million in assets will be required to obtain a license from the Monetary Authority of Singapore, while smaller funds will have to register with the regulator. All fund management companies will also have to develop a robust risk management framework by satisfying annual audit requirements and the employment of more investment professionals. While tighter rule will help ensure the long-term stability of the industry, smaller fund management companies might be forced to close as operating costs increase.

In China, there are a total of 67 asset management companies, of which 38 are Chinese-foreign equity joint ventures (57%). However, out of the top ten asset management companies according to the size of asset under management, eight are still Chinese companies, reflecting that companies with foreign participation do not generally have evident advantages over domestic companies. China is one of the world's largest potential markets for asset management, albeit fierce competition within the industry. It is predicted that total asset under management in China will be more than double by 2015.

6. Suggestions

With the strong capital inflow into Asia as well as the high growth in wealth in China, both Hong Kong and China are having huge potential in further developing the asset management markets. To grasp the business opportunities, Hong Kong and China should continue to improve their regulatory regimes and also further cooperate with each other.

Hong Kong should enhance its efficiency to facilitate the setting up of funds, including streamlining and coordination of the approval process which may involve various government authorities. Also, the incentives for setting up and operating fund business in Hong Kong have to be increased by providing further tax incentives for asset management business in Hong Kong and reviewing the eligibility of tax exemptions on the activities and nature of funds.

Hong Kong should also strengthen its cooperation with other jurisdictions. For example, negotiate and sign more Memoranda of Understanding in regulatory issues as well as double taxation agreements, which will enhance Hong Kong's attractiveness for overseas funds. Furthermore, given Hong Kong's privileged role and position in the development of China's market, further cooperation should be promoted via CEPA and other pilot schemes with Mainland cities to explore new business opportunities.

Note: This English version is translated from the Chinese version. In the event of any discrepancy between the Chinese and English versions, the Chinese version shall prevail.