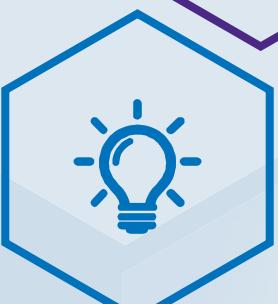




Hong Kong Asset Management Outlook

Key trends for 2021

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The world has faced unprecedented challenges over the past year, as governments grappled with containing the outbreak of Covid-19, economic growth slowed, and geopolitical tensions increased. For Hong Kong, social unrest and a strained US-China relationship added to the challenging environment. Despite these significant headwinds, Hong Kong's asset management industry has remained resilient and adapted quickly to the new reality brought about by Covid-19.

According to the Securities and Futures Commission's (SFC) latest Asset and Wealth Management Activities Survey, industry AUM increased by 20% year-on-year to HK\$28,769 billion (US\$3,694 billion) in 2019, with net fund inflows of HK\$1,668 billion (US\$214 billion)¹. The number of Type 9 licensed corporations in Hong Kong also increased by 10% year-on-year to 1,808 as at the end of 2019.

In 2020, policymakers introduced a number of regulatory reforms and incentives to drive the further growth of the sector and to increase Hong Kong's attractiveness as a fund domicile. These initiatives have been welcomed by the industry, and serve to reaffirm Hong Kong's status as Asia's leading fundraising centre and its leading asset and wealth management hub.

If you add to these measures, the ongoing development of the Greater Bay Area (GBA), the ever-expanding stock and bond connect schemes, its strategic regional location and its role as a bridge between mainland China and the rest of the world, then Hong Kong's financial services industry, including its asset managers, are well positioned for growth.

Against this backdrop, we have identified a number of key trends for 2021 that are likely to have a significant impact on the asset management industry in Hong Kong.



¹ 'Asset and Wealth Management Activities Survey 2019', SFC, August 2020, https://www.sfc.hk/web/files/ER/Reports/AWMAS_2019_EN.pdf



Mainland China is THE key growth engine

Mainland China will remain a strategic growth opportunity for Hong Kong's asset managers in 2021. The continued opening up of mainland China's asset management sector and broader financial services industry to foreign investment provides an opportunity for asset managers in Hong Kong to tap into the rapidly growing amount of wealth at its doorstep.

The Chinese fund industry surpassed the RMB20 trillion barrier for the first time in 2020. It is by far the world's most dynamic and digital market. Live-streaming of fund "education" sessions, highly-functional apps, high-profile promotion of star managers and CEOs on social media are all elements of the landscape in mainland China. It's also an equity-centric and active-focused market, both of which only increase its attractiveness to foreign managers. We should expect 2021 to see other managers join the ranks of BlackRock, Fidelity and AllianceBernstein in applying for a full retail fund management licence to operate in mainland China.

From a global perspective, mainland Chinese equities and bonds may become a growing component of portfolios as the country recovers more rapidly from Covid-19 than other developed nations and drives home its global leadership in a number of digital markets. Major indices will likely increase their allocation to mainland China, potentially adding again to the coffers of Hong Kong's asset managers.

Looking inside China, the GBA, with a population of 71 million and a combined GDP of US\$1.6 trillion, presents a more specific, wealth-oriented opportunity for asset managers. In 2019, 20% of all high-net-worth individuals in China lived in the GBA. Its special status will be enhanced with the imminent launch of the GBA Wealth Management Connect scheme, which will allow residents of the cities in the GBA to invest in eligible investment products distributed by banks in Hong Kong and Macao, and vice versa. While the scheme will start by offering low to medium risk products, with a quota of RMB 1 million per individual, we expect the scheme to evolve and expand over time, enlarging the overall size of the funds market.

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Increasing digital and operating model transformation to focus on the front office

2021 will see many asset managers continue to evolve their operating models and focus on the application of advanced technologies to their core processes – from portfolio construction through trade lifecycle management and out into fund accounting and administration. In assessing the potential costs of pursuing a broad programme of digitisation, many asset managers will (rightly) seek to outsource more elements of their operating model, particularly across the middle and back offices.

This transition to an operating model focused increasingly on the front office only is likely to accelerate in 2021, with asset managers focusing their internal spend on digitising those activities mostly directly related to managing money or managing clients, and improving customer engagement and experience. This might include ingesting non-traditional data sets and leveraging artificial intelligence (AI). Indeed, the ability of asset managers to process terabytes of near real-time data and deliver it in the form of novel, value-creating insights to portfolio managers and client advisors will be key to success in 2021 and beyond.

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ESG investing to become the new normal

Asset managers have a significant role to play in the development of environmental, social and governance (ESG) standards of performance and sustainable investing. Many major industry players are already embedding ESG lenses into their investment processes. Hong Kong, mainland China and their broader Asia counterparts for the most part lag their global competitors in this increasingly important space – the smartest ones are looking to catch up rapidly. To this end, the Hong Kong regulators are playing their part. The SFC's recent Consultation Paper on the Management and Disclosure of Climate-related Risks by Fund Managers, which proposes to amend the Fund Manager's Code of Conduct, will require fund managers to take climate-related risks into consideration in their investment processes, and to make appropriate disclosures to investors.

As the major asset owners in China and the broader Asia Pacific region follow the global trend and demand that their asset managers incorporate ESG into their selection and investment process, institutional asset managers will need to start measuring the impact of their investment portfolios, perform in-depth ESG analytics, aggregate ESG ratings and information, and provide ESG assurance. Those that are quick to take decisive steps in 2021 towards full ESG integration will be well positioned to enjoy a competitive advantage – not only with institutions, but increasingly with retail investors as more funds are in the hands of more purpose-driven Millennial investors.

One key step on the ESG journey for asset managers is equipping themselves with the right talent. In Hong Kong's financial services industry, there remains a notable shortage of skills and understanding in the area where finance and ESG intersect. A recent KPMG report on the future of Hong Kong's fund management industry found that the greatest skill shortage in the local labour market is expected to be for ESG specialists². Bridging the ESG talent gap will take time. The year ahead will therefore undoubtedly see firms increasing their efforts to recruit professionals who are knowledgeable about the application of ESG. Training and reskilling their existing workforce will also be an area of focus in 2021.

Lastly, China's 14th Five-Year Plan – which highlights environmental protection as a key focus area – coupled with its commitment to becoming carbon neutral by 2060, will have significant implications across the corporate landscape in Asia. While the transitional elements will unfold over decades, 2021 will be a foundational year where asset managers will be expected to work through the implications of the plan on real money investment flows and how to better integrate ESG factors into their investment processes.

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² 'Vision 2025: The future of Hong Kong's fund management industry', KPMG China, June 2020, <https://home.kpmg/cn/en/home/insights/2020/06/vision-2025.html>



Growth-seeking regulatory reforms enacted in 2020 will bear fruit in the year ahead

A number of regulatory reforms and tax incentives were introduced in 2020 to encourage local market growth and cement Hong Kong's position as Asia's premier asset and wealth management hub. The introduction of the Limited Partnership Fund (LPF) regime, amendments to the existing Open-ended Fund Company (OFC) regime and proposed reforms to provide competitive tax treatment for Carried Interest are all serving to increase Hong Kong's attractiveness as a fund domicile of choice. We have already seen the launch of several OFCs and a number of registrations under the LPF platform. We expect the LPF platform to be a popular vehicle for both Chinese and foreign general partners (GPs) looking to manage Asian capital in 2021.

The Hong Kong Government and regulators are expected to continue to focus on further tax and regulatory reforms in 2021. These reforms reflect a broader global trend to bring operations and investment structures onshore, which we expect to continue throughout the year. Asset managers looking to raise capital in Asia have more alternatives for fund vehicles than ever before, and Hong Kong ought to be a major beneficiary.

Furthermore, the Hong Kong Budget, announced on 24 February 2021, included some welcome incentives for Hong Kong's wealth and asset management industry. The Government has announced subsidies of up to 70% of expenses paid to local professional service providers of OFCs set up in or re-domiciled to Hong Kong in the coming three years, subject to a cap of HKD1 million per OFC. Similarly, a subsidy of up to 70% of the expenses paid to local professional service providers will be offered for qualifying REITs that list in Hong Kong in the coming three years, subject to a cap of HKD8 million per REIT. The SFC will announce further details regarding the subsidies in due course. In our view, this will generate significant returns from the economic activity and substance that will be established in Hong Kong from managing Hong Kong-based OFCs and qualifying REITs.



M&A activity to increase as competition intensifies

2020 saw a number of landmark deals in the global asset management industry, such as Morgan Stanley's purchase of Eaton Vance for around US\$7 billion, and Franklin Templeton's US\$4.5 billion acquisition of Legg Mason. These deals have obvious impacts on the Asian footprints of the merged firms. Locally, we saw J.P. Morgan Asset Management acquire the minority stake in its Chinese joint venture with China International Fund Management in a deal that valued the latter at a whopping US\$1 billion, or 50 times earnings. 2020 also saw Ares Management Corporation acquire a controlling stake in SSG Capital Holdings, a major Asian alternative asset management firm, as well as KKR's purchase of a 55 percent stake (valued at US\$1.1 billion) in the wealth management arm of the Commonwealth Bank of Australia.

We expect local deal and M&A activity to continue apace in 2021, especially as asset managers continue to face pressure on margins, and as competition in Hong Kong, mainland China and the broader Asian region heats up. Indeed, M&A will be an increasing motivator for CEOs seeking to grow their businesses. Some deals will be purely driven by costs and size, while others will be led by the need to expand product scope, distribution channels, geographies and talent.



Hiring and managing talent in the new reality

Covid-19 continues to push organisations across industries to adopt new ways of working. In the asset management space, portfolio managers are increasingly able to perform research and construct portfolios remotely. From a sales perspective, the traditional fly-in fly-out model may be permanently altered, but in a somewhat counter-intuitive way, with asset managers potentially seeking to deploy more people on the ground for face-to-face interaction with clients and, crucially, prospects. On the other hand, many clients have now become accustomed to engaging with their managers on an entirely virtual basis. It remains to be seen whether their behaviour will bounce back as the world recovers from Covid-19.

The pandemic has also thrown into sharp focus the efforts needed to retain a firm's most talented staff. According to KPMG's 2020 Global CEO Survey³, which was conducted in July/August 2020, talent risk was cited as the most significant threat to businesses. This is in stark contrast to the previous CEO survey conducted in January 2020 – prior to the global outbreak – where talent risk ranked behind 11 other risks to growth. CEOs acknowledged that losing key employees and attracting specialised talent have a critical impact on future business performance. Virtual working was seen to "loosen the ties" between a firm and its employees; this factor alone will likely drive some firms to ask their workers to return to the office in 2021, albeit on a more flexible basis than ever before.

In terms of talent pools, ESG specialists, data scientists and domain-centric technology experts will continue to be in high demand in 2021, as will professionals who have a comprehensive understanding of the China market. We believe that the highest demand will be for those who not only have a grasp of emerging technologies, but who also understand how to apply those technologies effectively to asset management problems and processes.



³ 'KPMG 2020 CEO Outlook: COVID-19 Special Edition', KPMG International, September 2020, <https://home.kpmg/xx/en/home/insights/2020/09/kpmg-2020-ceo-outlook-covid-19-special-edition.html>



eMPF platform moves closer to implementation

Hong Kong's Mandatory Provident Fund (MPF) market reached a significant milestone in 2020, with the net asset value of MPF schemes surpassing HK\$1 trillion in November.

The Mandatory Provident Fund Schemes Authority's planned implementation of the eMPF platform is a key development on the horizon, aimed at streamlining and automating existing administrative processes, lowering costs and increasing efficiency. With the eMPF platform expected to be built by the end of 2022 and a phased launch to commence shortly after, the year ahead is undoubtedly important for all stakeholders involved. In particular, the introduction of the eMPF platform will fundamentally change the business model of trustees in the MPF space, and could lead to some market consolidation. Trustees should use the year ahead to think creatively about how to adapt their existing business models, encourage and educate employees and scheme members about eMPF, and provide more value-added services. The new system could present a significant opportunity for trustees to increase their AUM and help improve the level of pension provision in Hong Kong.



The rise of alternative investments

We expect the AUM in Asia-based alternative investments to continue to rise in 2021 as institutional investors and sovereign wealth funds increasingly allocate capital to the industry in search of yield and diversification. This is a significant opportunity for local asset managers.

Investors in alternative asset classes – like their long-only counterparts – are also increasingly looking to branch out from traditional investment strategies and embrace sustainability by way of ESG-flavoured real estate, private equity and infrastructure funds. GPs are also increasingly looking to embed ESG factors in their core investment processes – in due diligence processes, deal memos and reporting to limited partners.

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A new regulatory regime for virtual asset trading platforms

Following the SFC's issuance of a position paper in late 2019 for a regulatory framework for virtual asset trading platforms that offer trading of at least one security token, there have been notable developments in the virtual assets space.

In November 2020, the Hong Kong Government issued a consultation to implement a new regulatory framework requiring all centralised virtual asset exchanges to apply for an SFC licence, whether they are operating in Hong Kong or target Hong Kong investors. Licensees will be allowed to offer services to professional investors only. A bill to enact the new regime will likely be introduced to Hong Kong's Legislative Council this year.

If the bill is enacted, all virtual asset trading platforms will be regulated under either the existing opt-in framework introduced in 2019, or the proposed new licensing regime. The proposed changes will have wide implications for virtual asset businesses. Affected businesses will need to carefully consider the scope of permissible activities under the licence, what resources and experience they require, and whether they have adequate risk management and compliance procedures in place.

While the challenging macroeconomic environment looks set to remain over the coming months, Hong Kong's asset management industry is well positioned for another strong year in 2021, driven largely by these trends. The industry will continue to be supported by policymakers that remain committed to encouraging growth and reaffirming Hong Kong's status as a premier international financial centre and asset and wealth management hub. We believe that asset managers that take affirmative action in 2021 to capitalise on these trends will be well positioned for growth and superior performance.

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