

# PECC-SINCPEC International Conference

## Competitiveness Enhancement: Business Financing and Capital Market Reforms in China

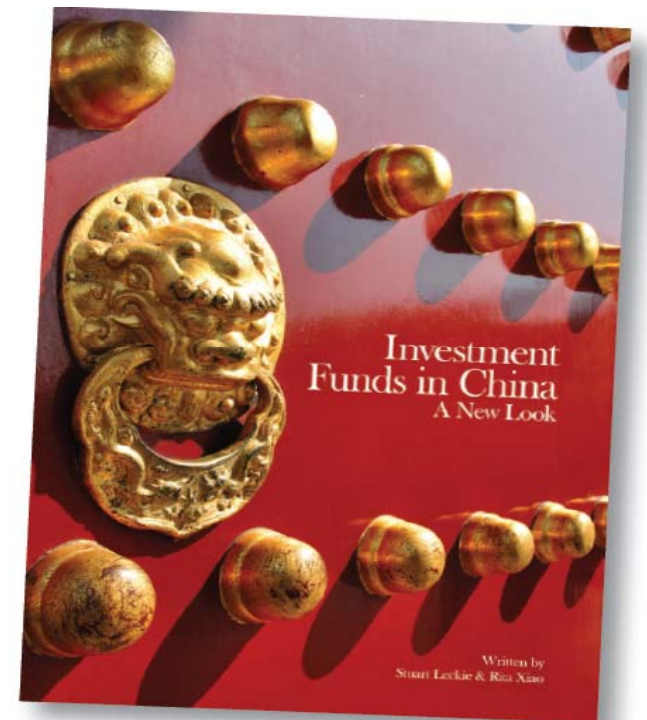
### INVESTMENT FUNDS IN CHINA

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- **Capital Markets**
- **Financing Channels**
- **Investor Landscape in China**

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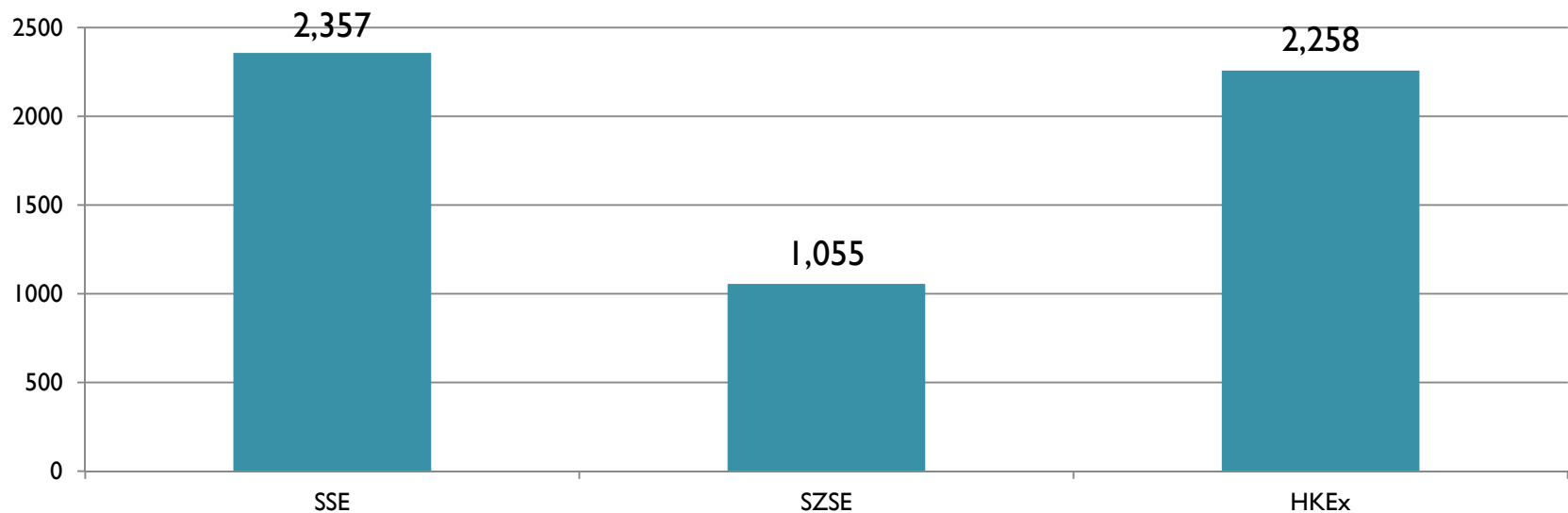
- **Institutional Investors**
  - Investment Fund Companies
  - Insurance Companies
  - Pension Funds
  - Sovereign Wealth Funds
  - Trust Companies and PE Firms
- **Capital Market Reforms**

Note: the exchange rate used for the presentation is RMB6.30 = USD1, as at 31 December 2011,

# Capital Markets - Equities

- Combined market capitalisation of Shanghai, Shenzhen and Hong Kong Exchanges together (USD5,670 billion) far surpassed that of Tokyo (USD3,325 billion)
- Launch of ChiNext – China's NASDAQ
- Margin trading, short selling and index futures started
- Volatility remains high

**Market Capitalisation of Stock Exchanges**  
(as at 31 December 2011, in USD billion)

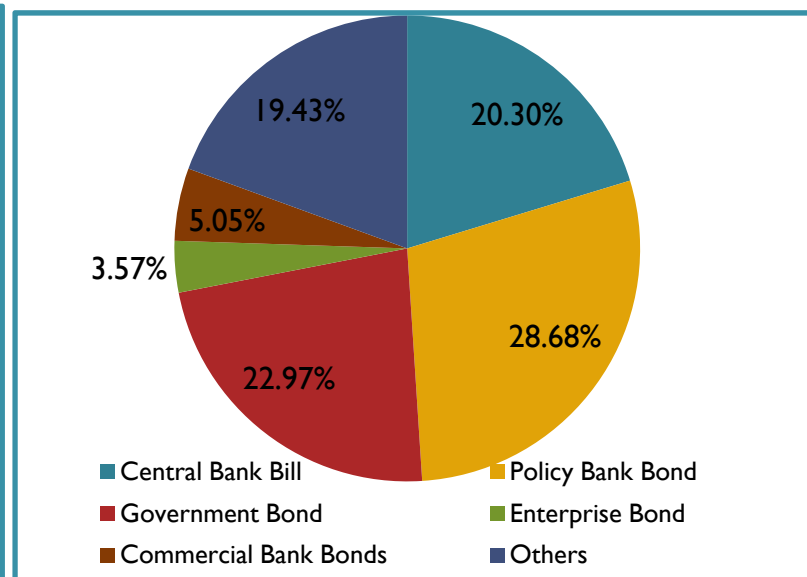
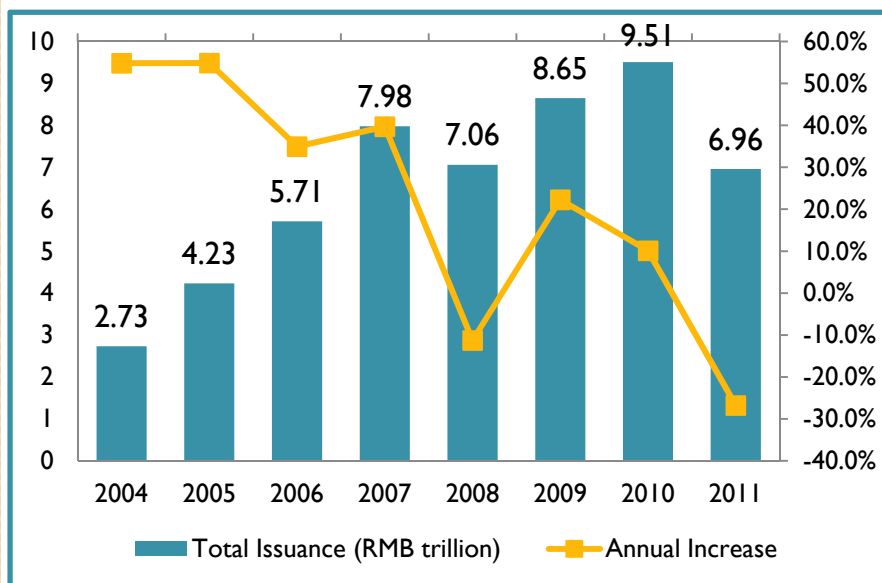


Source: Stirling Finance research, WFE

# Capital Markets - Bond

- Recent decline in total issuance due to sharp decrease in central bank bills
- Unbalanced bond issuers:
  - central bank bills, treasury bonds and policy bank bonds still account for 72% of the total issue, although this is down from 93% in 2007
  - corporate bonds – the market is dominated by state-owned entities
- High total issuance, but low liquidity, thus no market-oriented pricing mechanism

## Bond Issuance and Structure (2011)



Source: Annual Review of China's Bond Market, by China Government Securities Depository Trust & Clearing Co., Ltd.

# Financing Channels

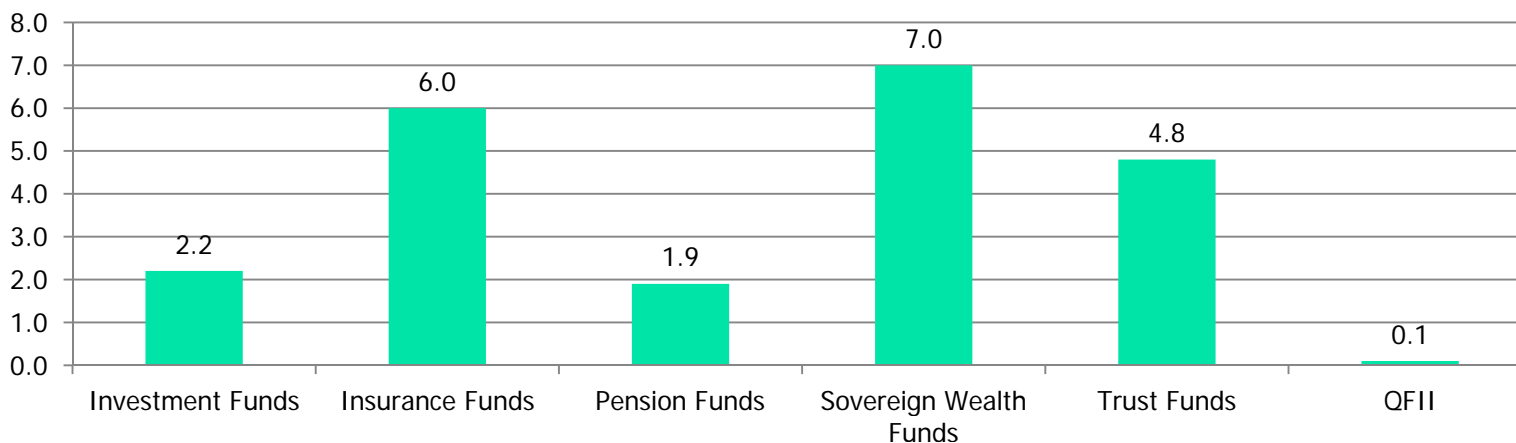
**Capital Markets:** all about efficient asset allocation, and enhancing competitiveness

- **Bank loans** still dominate business financing for both SOEs and SMEs, with RMB110 trillion banking assets, more than 90% of all financial assets in China
- **IPO** is a common way to enhance competitiveness:
  - Access to new funding;
  - Build market awareness;
  - Bring in large stakeholders, usually institutional investors;
  - Eliminate agency problem;
  - Broaden governance structure.
- **Bond market:** dominated by large companies
- **Venture Capital (VC) & Private Equity (PE):** now expanding in China, but usually very long-term investments involved
- **Private lending on the rise:** shadow banking system creating public attention, i.e. Wenzhou problem of run-away CEOs

# Investor Landscape in China

- >80% trading volume comes from retail investors – speculative activities
- But evolving towards a more even mix of investor classes
- Institutional investors progressively taking over from retail investors as the major force
- Assets continue to expand
- More interaction among institutional investors

**Institutional Investors in China (RMB trillion)**



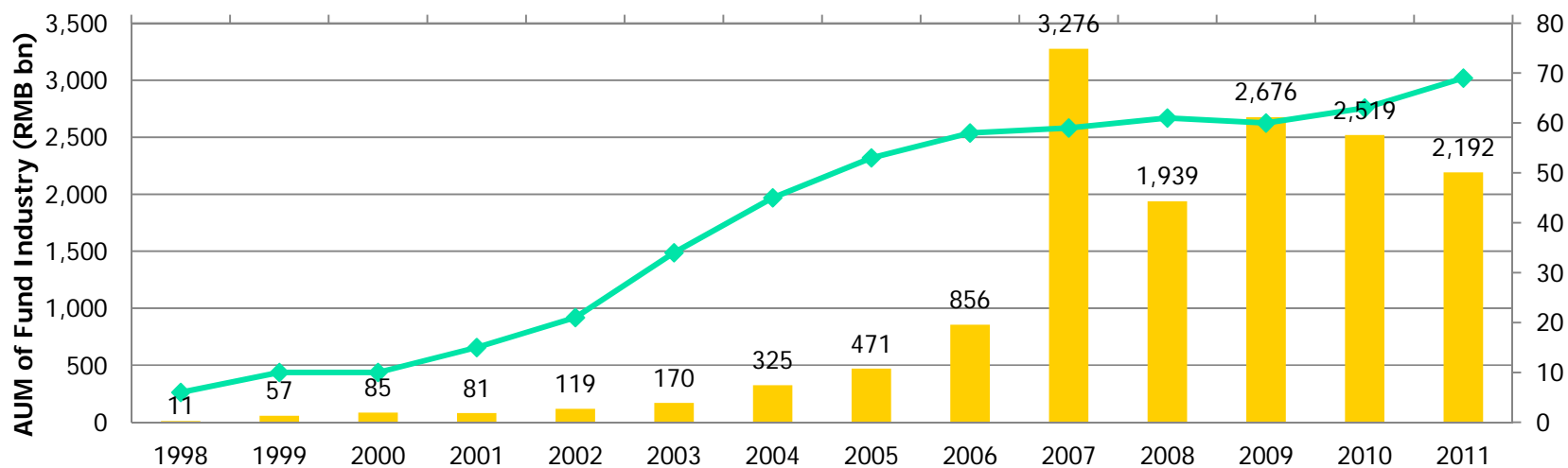
Source: CSRC, CIRC, MoHRSS, CBRC, SAFE, Stirling Finance Research

\* Pension Funds here represents accumulated balances in the State Urban Pension System.

# Investment Funds Companies

- Commenced in 1998, fast expansion until 2007, but shrank during last 5 years
- 69 Fund Management Companies (FMCs) authorized by the CSRC, with 914 registered investments funds in total as at 31 December 2011
- Comparatively high openness to global players: 39 JVs out of 69 FMCs in total
- Active in both stock and bond markets, but do not always act as rational institutional investor.

**FMCs and Fund Industry AUM of China**

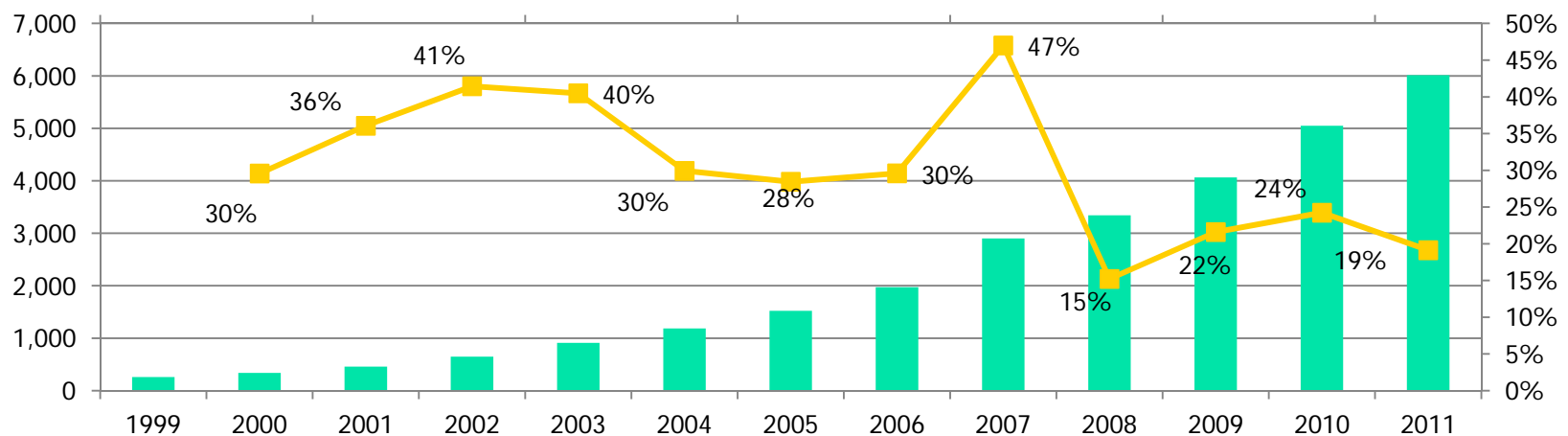


Source: China Galaxy Securities Research

# Insurance Companies

- Rapid expansion: from RMB260 billion assets in 1999 to RMB6 trillion in 2011
- Relatively low openness: foreign insurers still face regulatory barriers in geographic expansion and some important business lines, thus only 4% market share for foreign life insurers altogether, and only 1% market share for all foreign non-life insurers.
- Facing strict regulations on insurance investments
  - Currently more than 50% insurance assets put into bonds
  - Less than 2% holding of stock market capitalisation by insurers
- Not generally active in trading, but focus on long-term strategic investments.

## Total Assets of Insurance Industry (RMB billion) and Annual Growth



Source: CIRC



# Pension Funds

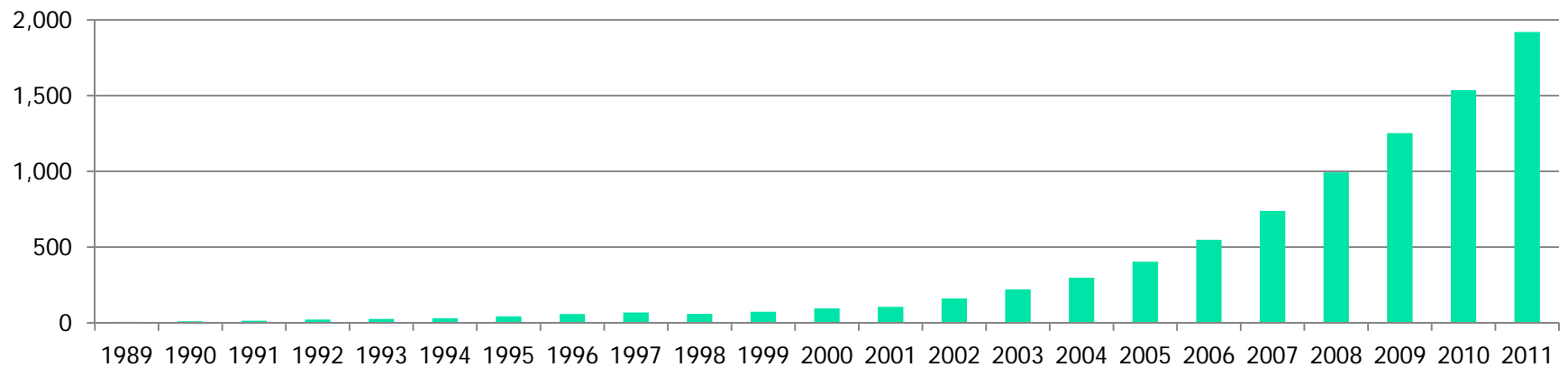
## Pension Assets:

- Cumulative balances in state urban pension system rose to RMB1.9 trillion in 2011, largely derived from individual accounts, with exponential growth in the last 2 decades

## Investment Scope:

- State pension assets are limited to bank deposits and government bonds, with only 2 percent p.a. returns in the past 10 years;
- National Social Security Fund will now manage RMB100 bn of Guangdong Province's individual account pension assets

## Growth in State Urban Pension Total Assets (RMB bn)



Source: Annual Reports of Ministry of Human Resources and Social Security

# Sovereign Wealth Funds

- Top 10 SWFs account for almost 80 percent of the total assets of all SWFs
- China has 4 out of top 10 in the world (if we count HKMA)

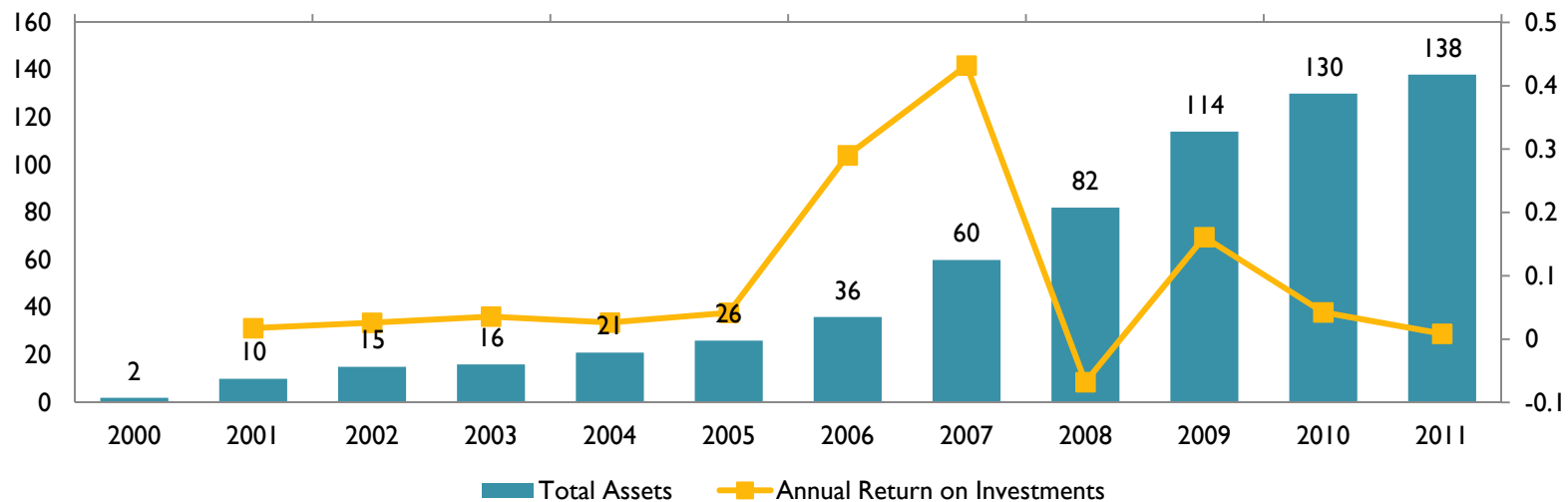
## Ten Very Large Funds in the World (updated in December 2011)

| Country           | Fund Name  | Assets<br>(USD, billion) | Inception | Source of Funds  |
|-------------------|--|--------------------------|-----------|------------------|
| UAE - Abu Dhabi   | Abu Dhabi Investment Authority                       | 627                      | 1976      | Commodities      |
| China             | SAFE Investment Company                              | 568                      | 1997      | Non- commodities |
| Norway            | Government Pension Fund – Global                     | 560                      | 1990      | Commodities      |
| Saudi Arabia      | Saudi Arabia Monetary Agency                         | 473                      | N/A       | Commodities      |
| China             | China Investment Corporation                         | 410                      | 2007      | Non- commodities |
| Kuwait            | Kuwait Investment Authority                          | 296                      | 1953      | Commodities      |
| China – Hong Kong | Hong Kong Monetary Authority<br>Investment Portfolio | 293                      | 1993      | Non- commodities |
| Singapore         | Government Investment Corporation                    | 248                      | 1981      | Non- commodities |
| Singapore         | Temasek Holdings                                     | 157                      | 1974      | Non- commodities |
| China             | National Social Security Fund                        | 138                      | 2000      | Non- commodities |

Source: Sovereign Wealth Fund Institute; Stirling Finance Research

# Sovereign Wealth Funds - NSSF

- Established in 2000 as pension fund of last resort, but acting like SWF
- USD138 billion assets: 58% direct investments and remaining 42% by appointed third parties: domestic FMCs and global managers including AllianceBernstein, BlackRock, Schroders, etc.
- Current asset allocation: 51% into fixed income, 32% in stocks, 16% in industrial investments and 0.6% in cash and cash equivalent
- NSSF international allocation: currently at 7%, with upper limit at 20%
- Very long-term institutional investor in the capital markets, and every move is watched closely by the market

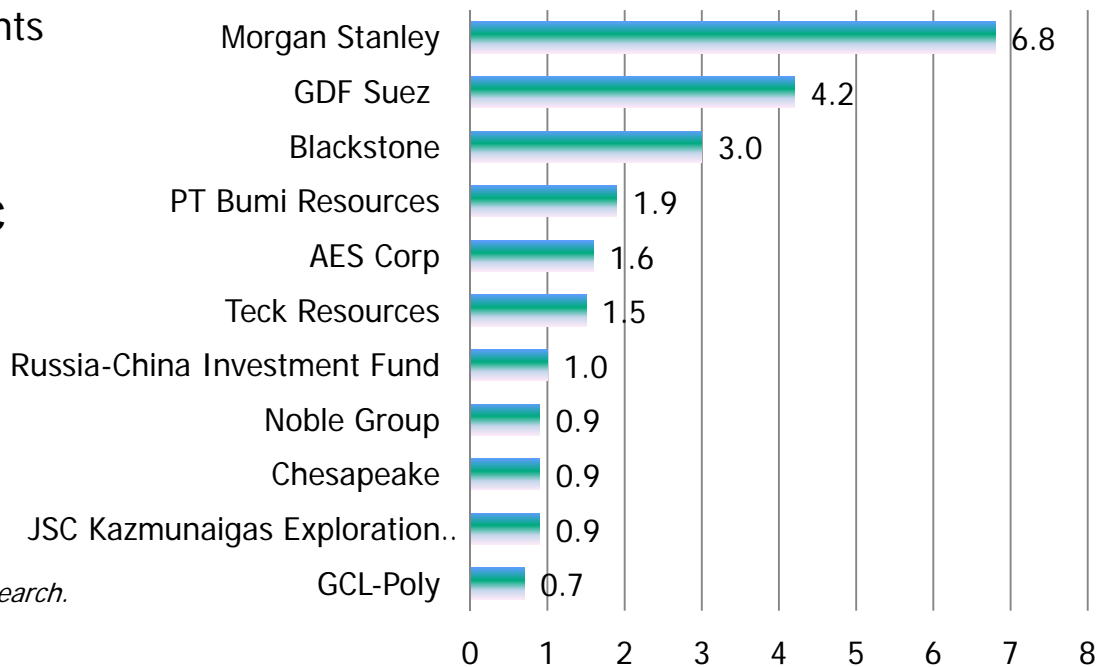


Source: NSSF; Stirling Finance research

# Sovereign Wealth Funds - CIC

- CIC was established in September 2007
- Asset size increased from initial USD200bn to USD410bn as at 31 December 2010
- 59% of assets allocated through external appointments
- Domestic direct investments
  - USD67bn to acquire Central Huijin
  - Major shareholder of largest banks in China
- International direct investments

## Largest Overseas Investments of CIC (in USD billion)



Source: Financial Times; Stirling Finance Research.

# Sovereign Wealth Funds - SAFE

- China's FX reserves as of 31 December 2011: USD3.18 trillion
- Hong Kong subsidiary ("SAFE Investment Company Limited") established in June 1997, with estimate assets of USD568bn as at 31 December 2011
- Not active investor in domestic capital markets
- Quietly built up stakes in over 50 European companies, Australian banks and PE funds

## SAFE Overseas Investments Reported in Financial Media

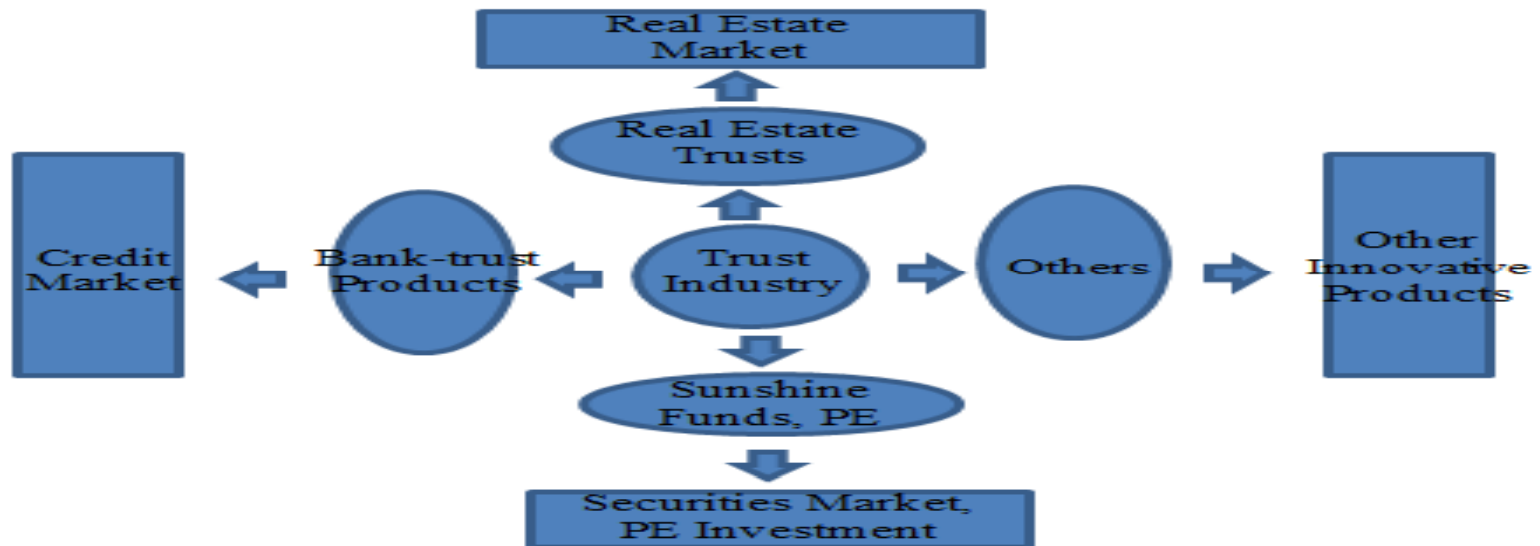
| International Classification Board Subsector | Country | Company                          | Cost (in USD Million) |
|--|---------|----------------------------------|-----------------------|
| Oil & Gas                                    | UK      | BP Global                        | 2,000.0               |
| Oil & Gas                                    | UK      | Royal Dutch Shell Plc            | 1,166.5               |
| Mining                                       | UK      | Rio Tinto Plc                    | 550.9                 |
| Mining                                       | UK      | BHP Billiton Plc                 | 371.7                 |
| Food & Drug Retailers                        | UK      | Tesco Plc                        | 444.8                 |
| Banks  | UK      | Barclays Plc                     | 345.4                 |
| Banks  | UK      | Royal Bank of Scotland Group Plc | 340.9                 |
| Utilities - Other                            | UK      | National Grid Plc                | 332.7                 |

# Trust Companies and PE Firms

## Trust Companies:

- Exponential growth: from RMB150 billion in 2004 to RMB4.8 trillion in 2011
- Most flexible type of institution in fundraising and investing

## Interaction of Trust Industry with Other Markets



## PE Firms:

- Long-term capital commitment, usually for 5-8 years
- Quick expansion, but largely unregulated in China until December 2011
- National Development and Reform Commission (NDRC) will be the regulator for large PE

# Capital Market Reforms

- Prevailing Problem 1: speculative trading activities and high volatility
- Reforms: encourage more institutional investors, such as pension funds, sovereign wealth funds, insurance companies, Qualified Foreign Institutional Investors (QFIIs), etc., for more long-term strategic investing
  - Guangdong RMB100 billion pension mandates hands out to the NSSF
  - Continuous relaxation on investment restrictions regarding stocks and bonds for insurance companies and Enterprise Annuities
  - QFII & RQFII: just expanded to USD80 billion and RMB70 billion respectively

**LTM ADT & Velocity of Major Global Exchanges (in US\$bil)**



Source: WFE, as of 29 February 2012

○ = LTM average velocity

# Capital Market Reforms

- **Prevailing Problem 2: IPO fever versus low dividend payouts**
- **Reforms: curb speculation and fine-tune market mechanism**
  - Specific limits on daily price movements and transaction volume to curb excessive speculation on IPOs
  - Develop rules on fair profit sharing and require dividend payout
  
- **Prevailing Problem 3: lack of transparency**
- **Reforms: improve information disclosure, and investigate market irregularities**
  - Very large cases under investigation
  - Regarding IPOs, information should be disclosed in a comprehensive, complete and accurate manner



# Capital Market Reforms

- **Prevailing Problem 4: financing difficulties for SMEs**
  - SMEs in China employ 80% of working population, account for 60% of China's GDP, and contribute 50% of government's tax revenue
  - Big SOEs have more capital than they need, so they become lender through financial subsidiaries
  - SMEs face fund raising difficulty and turn to shadow banking system at up to 30% p.a. lending rate
- **Reforms: open more channels for business financing to "serve the real economy"**  
**(by Premier Wen Jiabao)**
  - Formalise private lending in Wenzhou, and allow direct overseas investments for individuals – up to a cap of USD200 million in total p.a.
  - Plan for "new third board" – OTC equities market in China
  - High yield bond market for small businesses
  - Encourage PE and VC Funds to help small firms during pre-listing period

“This is not the End or the Beginning of the End,  
but may be the End of the Beginning!”

Thank You!

## INVESTMENT FUNDS IN CHINA

