Global Investors' Survey

Accessing Mainland China's Onshore Bond Markets

November 2016

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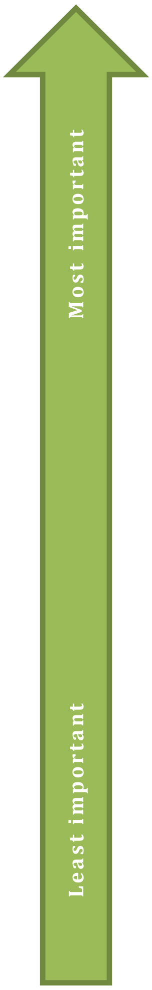
A. Executive summary

In September 2016, AFME[1], AIMA[2], ALFI[3], ASIFMA[4], Irish Funds[5], KOFIA[6] and SIFMA AMG[7] conducted a global survey on investors' interest in Mainland China's onshore bond market, which is the largest of its kind to date. The aim of the survey was to query investors (both existing and potential) globally about their views on accessing Mainland China bond markets, their primary concerns and what they would like to see changed and developed from a policy perspective. As a next step, in early 2017, ASIFMA will publish a white paper on the development of China's capital markets which will incorporate policy and regulatory recommendations based on the findings of this survey.

The survey was conducted online between 14 September and 7 October 2016 and feedback was collected from over 100 respondents worldwide, representing a total estimated global assets under management (AUM) of over USD21 trillion.
Participants were asked questions about the importance of a number of topical concerns that they are facing when considering investment in China's onshore bond market: (i) macro-economic factors, (ii) capital market development, (iii) credit information, and (iv) legal and operational concerns.



Score on a scale of 1 (most important) to 5 (least important)	Concerns	Legal and operational	Capital market development	Credit information	Macro-economic
1.56 to 2.00	Free repatriation of invested funds	✓			
	Clear beneficial ownership rules	✓			
	Clarity on withholding tax and VAT regime	✓			
	Liquidity in secondary bond market		✓		
	Clear and stable government policy on financial markets				✓
	Free flow of capital cross-border		✓		
	Recognition of close out netting and clear bankruptcy default mechanism	✓			
	Freedom to use trading and settlement infrastructure that is integrated with global markets	✓			
2.01 to 2.20	International settlement cycle	✓			
	Availability of hedging instruments such as access to onshore FX products, futures, CDS and IRS markets		✓		
	Corporate governance		✓		
	Availability of credit information offshore (e.g. from information providers) on China market			✓	
	Value of the RMB				✓
	Availability of international ratings at bond instrument level			✓	
	Clear and feasible KYC rules for establishing relationships with counterparties	✓			
	Coverage of issuers by international credit rating agencies			✓	
2.21 to 2.46	Inclusion in global bond indices		✓		
	Market driven interest rates		✓		
	Default rate of Chinese corporates				✓
	Leverage of Chinese corporates				✓
	Differentiation within domestic rating scales			✓	
	Availability of nominee/omnibus account structures	✓			
	Availability of RMB (offshore/onshore)				✓
	Availability of offshore settlement	✓			
2.47 to 3.25	On-the-run benchmark yield curve		✓		
	Range of products available for foreign investors		✓		
	Availability of documentation and regulations in English		✓		
	Wide and diversified investor base		✓		
	Access for foreign underwriters to the primary market		✓		
	Established classic "true sale" repo market		✓		
	GDP Growth				✓
	Property market prices				✓

[1] AFME, Association for Financial Markets in Europe, http://www.afme.eu/
[2] AIMA, Alternative Investment Management Association, https://www.aima.org/
[3] ALFI, Association of the Luxembourg Fund Industry, http://www.alfi.lu/
[4] ASIFMA, Asia Securities Industry & Financial Markets Association, http://www.asifma.org/
[5] Irish Funds, Irish Funds Industry Association, http://www.irishfunds.ie/
[6] KOFIA, Korea Financial Investment Association, http://eng.kofia.or.kr/index.do
[7] SIFMA, Securities Industry and Financial Markets Association, http://www.sifma.org/

Over the last couple of years, the Chinese government has accelerated efforts to attract more foreign investments, providing foreign investors with improved access to the world's third largest bond market. Despite the loosened restrictions on capital inflows, the market still lacks depth, with foreign investors holding less than two percent of all outstanding bonds in China. The results of the survey indicate that there are still a large number of impediments for foreign investors that the Chinese government may wish to consider in order to fully open its capital market, in line with the objectives described in the 13th Five Year Plan. Indeed, of the 32 factors that were examined, almost all factors are considered of significant importance. More specifically, 26 out of 32 factors received an average score that is below 2.5 (on a scale from 1 to 5, with 1 being most important and 5 being least important).

Whilst all factors are considered significant, we note the relative importance of the technical barriers to participation (i.e. legal and operational concerns) compared to the macroeconomic impediments (such as GDP growth or property market prices), in spite of the current economic climate in the country. For example, amongst the priorities for international investors are (i) free repatriation of invested funds, (ii) clear beneficial ownership rules, and (iii) clarity on withholding tax and value added tax (VAT) regimes. Although survey respondents are long term investors, the ease of repatriating invested funds is a significant concern, and one which should be addressed by removing lock-up periods, repatriation caps and other restrictions for QFIIs and RQFIIs.

In terms of capital market development, the survey reveals that liquidity in the secondary bond market and free flow of capital across borders are also critical concerns. In addition, clarity, transparency, and stability of rules are crucial for international investors whether around withholding tax or more general financial markets policies.

We should highlight that many of the factors included in the survey are interrelated. For example, liquidity in the secondary bond market is considered to be of significant importance to respondents; but other factors such as a classic true sale repo market, access for foreign underwriters to the primary market and a wide and diversified investor base are required to develop liquidity in the secondary bond market. Chinese authorities should therefore take a holistic view when considering policy priorities and the sequencing of their capital market reform agenda.

When comparing responses from investors according to their geographical location, assets under management, or investor type, we did not identify substantial differences in the survey results. Survey respondents generally share the same concerns with some slight differences in terms of score assigned to each factor.

In terms of investment preferences, international investors generally favor the highest rated investments (or instruments with a high credit quality) which is expected as investors need to get comfortable with a particular country before allocating a more significant part of their assets to lower rated instruments.

B. Respondent Profile

Responses were collected from over 100 investors worldwide, representing 36% of the top 50 investors in the U.S., 20% of the top 100 investors in Europe and 27% of the top 100 investors in Asia. The majority of the responses (65%) came from asset managers, with banks (12%) being the next category.

A majority of the respondents (70%) were based in Asia, with 21% of the respondents being based in Europe. 32% of the respondents have their headquarters in Asia, 39% in Europe and 25% in North America (see Figure 1 and 2).

The respondents profile represented a good mix in terms of size, with 23% of the respondents having USD<10 billion AUM, 18% having USD10-100 billion AUM, 32% having USD100-500 billion AUM and 27% having USD>500 billion AUM (see Figure 3).

Figure 1: In which region do you work?

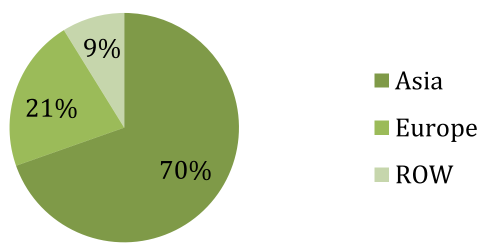


Figure 2: In which region is your organization headquartered?

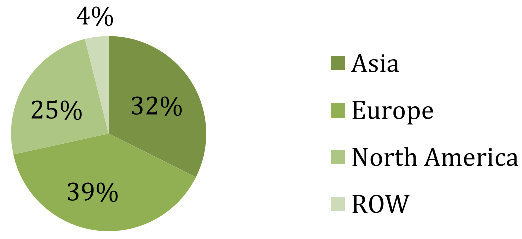
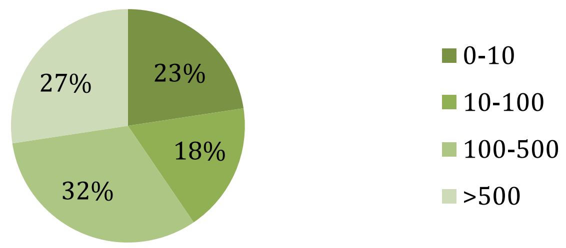


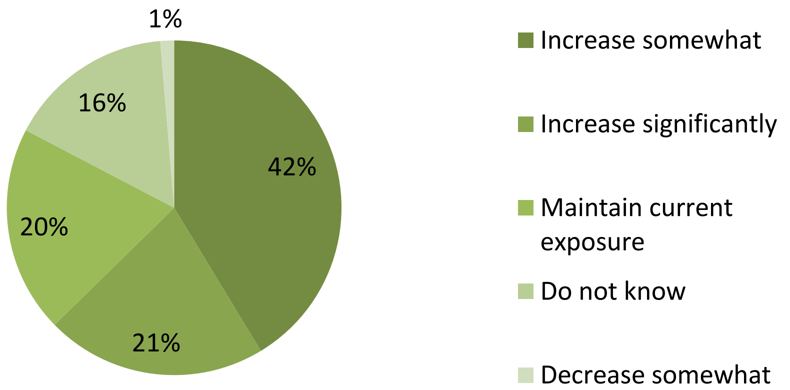
Figure 3: What is your firm's most current Assets Under Management (AUM) globally (In USD, Billion)?



C. Investment Expectations

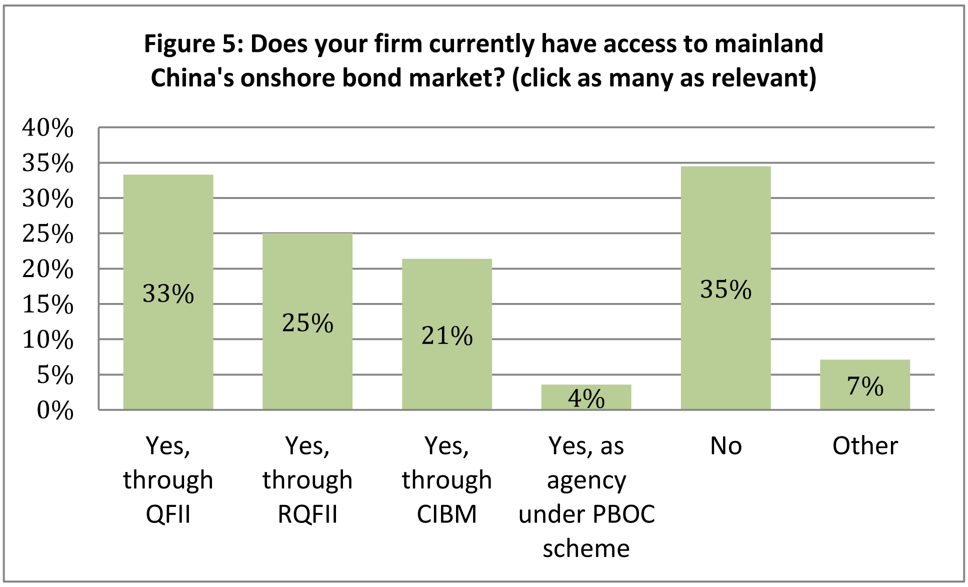
- A majority of the respondents (51%) are already investing in China's onshore bond market, while 33% are not investing but are planning to invest in the next 12 months. Only 15% of the respondents have no plans to invest over the next 12 months.
- The results of the survey suggest that there is still a lot of appetite to invest in China in spite of recent concerns about an economic slowdown, the depreciation of the yuan and market instability, with 63% of the respondents planning to increase their exposure over the next 12 months, 20% to maintain their current exposure and only 1 respondent planning to decrease exposure somewhat. However these results could be skewed as investors that are not interested in investing in China might not have responded to the survey (see Figure 4).
- The survey reveals regional differences in investment expectations with respondents based in Asia being slightly more bullish than respondents based in Europe. U.S.-headquartered firms appear the most bullish while European headquartered investors seem to be less inclined to increase their exposure.
- In terms of the type of investor, asset managers are slightly more bullish (with 68% planning to increase exposure) than banks (with 55% planning to increase exposure).
- The higher the investor's AUM, the more positive is the investment expectation, perhaps reflecting the greater commitment to the region.

Figure 4: What is your expectation regarding investment exposure to the Chinese onshore bond market over the next 12 months?



D. Current Access

At the time of the survey, 65% of the respondents already have access to the China onshore bond market through QFII (33%), RQFII (25%), CIBM (21%), agent under the PBOC scheme (4%) or other channels (see Figure 5).



E. Legal and Operational Concerns

- Overall, free repatriation of invested funds, clear beneficial ownership rules and clarity on withholding tax and VAT regime are the most important legal and operational concerns. They are also the most important overall concerns across all categories (macro-economic, capital market development, credit information, and legal and operational concerns).
- Clear beneficial ownership rules, the recognition of close out netting and clear bankruptcy default mechanism, clear and feasible KYC rules, and freedom to use trading and settlement infrastructure integrated with global markets are more important for respondents based in Europe than for respondents based in other regions.
- Recognition of close out netting and clear bankruptcy default mechanism, clear and feasible KYC rules and the availability of nominee/omnibus account structures are more important for banks compared to other types of investors, likely as they are more active as intermediaries in the capital markets where these concerns are prevalent.

F. Capital Market Development Concerns

- Overall, liquidity in the secondary bond market and free flow of capital across borders are the most important capital market development concerns for the respondents. These are followed closely by the availability of hedging instruments, corporate governance and inclusion in global bond indices. All these factors have been rated as extremely important as next steps for the development of the bond market. A classic true sale repo market, access for foreign underwriters to the primary market and a wide and diversified investor base are less important factors in spite of the fact that these are interrelated and required to develop a liquid secondary bond market.

- Not surprisingly, for respondents based in Asia or headquartered in Asia, the availability of documentation and regulations in English is of lesser importance than for respondents based elsewhere in the world.
- Inclusion in global bond indices is substantially more important for respondents based outside Asia than for respondents based in Asia.
- Availability of hedging instruments onshore and availability of documentation and regulations in English are main concerns for respondents based in Europe.
- Corporate governance is one of the most important capital development factors for respondents headquartered in the U.S.
- Overall, banks tend to attach more importance to capital market development concerns than asset managers and other categories of investors, perhaps because of their role as intermediaries in the capital markets.
- Availability of hedging instruments is more important for banks than for other types of investors as likely they need to hedge their risks when dealing with their clients.
- An established true sale repo market and a wide and diversified investor base are factors that are more important for banks than for other types of investors. Again, this is perhaps related to their role as intermediaries in the capital markets.
- Availability of hedging instruments is more important for the investors with over USD500 billion AUM than for smaller investors.

G. Credit Information Concerns

- Overall, the availability of credit information offshore is the most important ‘credit information’-related concern whilst differentiation within domestic rating scales is the least important one probably because international investors do not rely on domestic ratings.
- The coverage of issuers by international credit rating agencies and the availability of international ratings at bond instrument level are of a higher degree of importance for respondents based in Europe compared to respondents based elsewhere in the world.
- The availability of international ratings at bond instrument level is more important for firms headquartered in Europe compared to firms headquartered elsewhere in the world.
- The coverage of issuers by international credit rating agencies is of lesser importance for investors with AUM of USD10-100 billion compared to other investors.

H. Macro-Economic Concerns

- Overall, in terms of macro-economic factors, fixed income investors are primarily concerned with clear and stable government policies on financial markets and the value of the RMB – as this can substantially erode profits for fixed income investments. There is less of a concern about the economy, leverage and property prices. In order to attract foreign investors, it is therefore important to protect the stability of the RMB and develop clear and stable policies that international investors can understand and rely on.

- For respondents based outside Asia, the value of the RMB is more important than for respondents based in Asia. For respondents based in Europe, the value of the RMB is in fact their number one concern possibly reflecting the fact that non-Asian investors are more exposed to currency fluctuations.
- Not surprisingly, for respondents based in Europe, the availability of the RMB offshore/onshore is more important than for respondents based elsewhere in the world.
- For respondents whose headquarter is based in North America, the value of the RMB is more important than clear and stable government policies on financial markets.
- For asset managers, the value of the RMB is as important as clear and stable government policies, whilst for banks, the value of the RMB does not seem to be a major concern perhaps as they may have better access to RMB through their holding of deposits.
- For banks, the leverage of Chinese corporates and the availability of RMB offshore/onshore are as important as clear and stable government policies, whilst these are of lesser importance for asset managers.
- The value of the RMB is the number one macro-economic concern for respondents with AUM of USD10-500 billion. This is less of a concern for investors with <USD10 billion AUM and for investors with >USD500 billion AUM.
- Default rates of Chinese corporates and leverage of Chinese corporates are more of a concern for smaller investors.

I. Investment Preferences

- In terms of investment preferences, international investors generally want to access the highest rated investments or instruments with a high credit quality which is natural as investors need to first get comfortable with a particular country before moving their way down the credit curve for investment purposes.

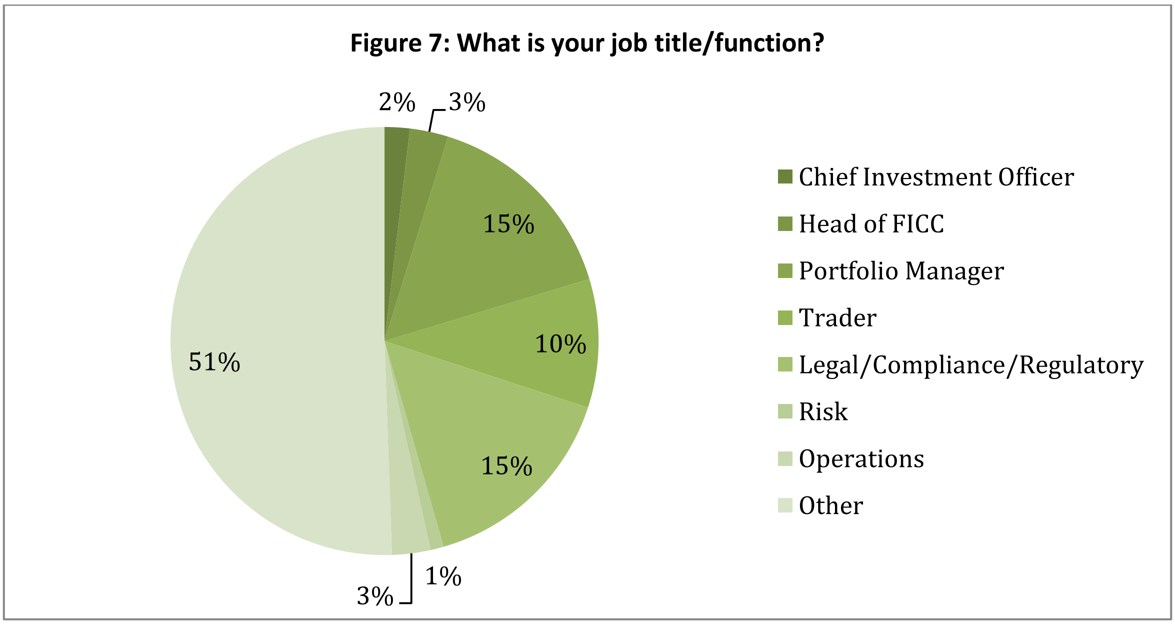
Figure 6: Investment preferences

	Investment preferences	Score on a scale of 1 to 10 (1 most preferred, 10 least preferred)
1	Central government securities and central government agencies	2.06
2	Policy Banks	3.47
3	Corporates and Financial Institutions with high credit quality but lower yield	3.98
4	Local government securities and LGFV	4.10
5	Panda bonds	5.85
6	Corporates and Financial Institutions with lower credit quality but higher yield	5.97
7	Index funds	6.15
8	Green bonds	7.45
9	Project and infrastructure finance	7.79
10	Structured credits (including ABS etc.)	8.18

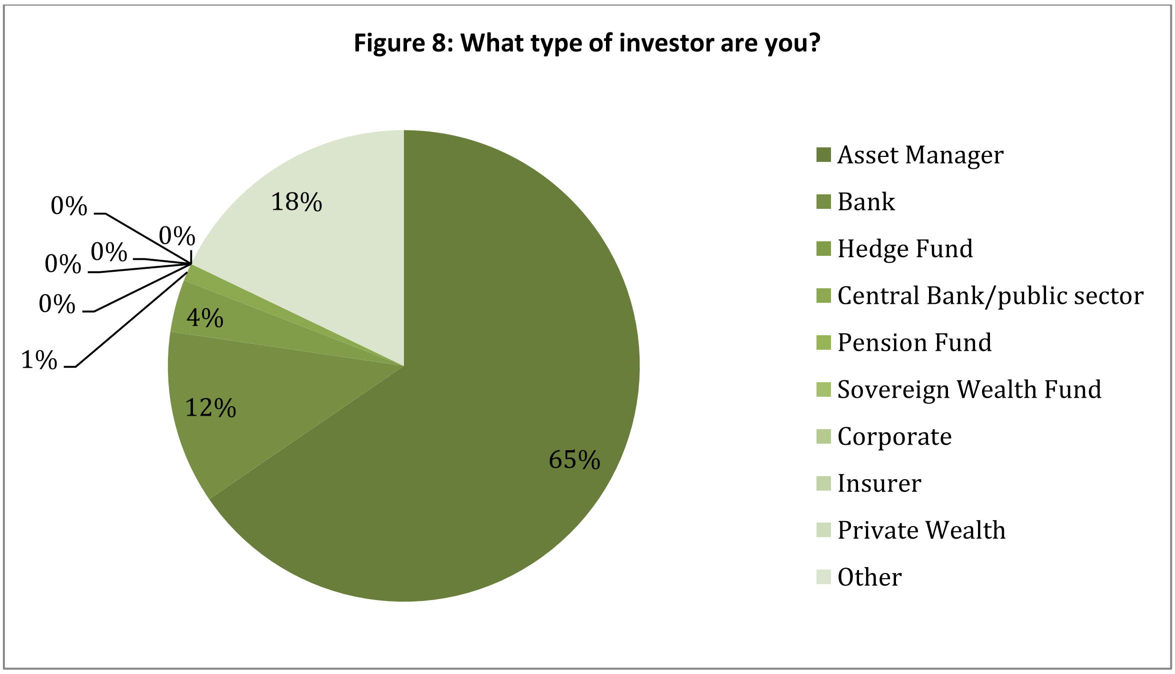
- Overall, the top three investment preferences are central government securities/agencies, policy banks and corporates and financial institutions with high credit quality. The bottom three investment preferences are structured credits, project and infrastructure finance and green bonds.
- Panda bonds score relatively low, which may imply foreign investors are more interested in accessing (mainly sovereign) domestic issuers that they cannot otherwise access. Panda bonds might be more interesting to domestic investors.
- Respondents based in Europe or headquartered in Europe are also interested in investing in local government securities and LGFV.
- The largest investors (with AUM of >USD500 billion) are more interested in investing in policy banks compared to smaller investors.

ANNEX: Survey results

1. What is your job title/function?

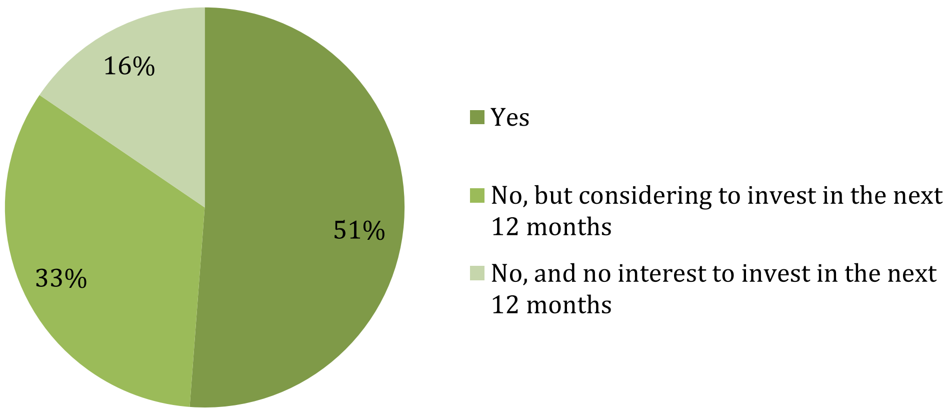


2. What type of investor are you?



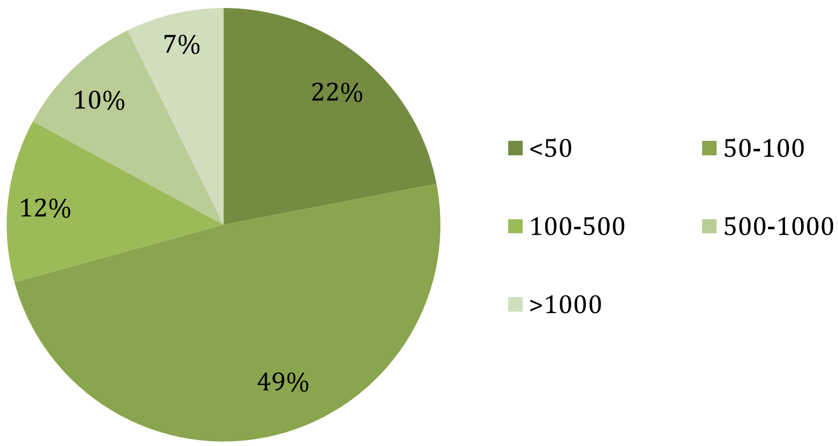
3. **Does your firm currently invest in mainland China's onshore bond market?**

Figure 9: Does your firm currently invest in mainland China's onshore bond market?



4. **AUM Invested in China is (in USD, Million)**

Figure 10: AUM Invested in China is (in USD, Million)



5. **How important are the following macro-economic concerns when you consider investing in China's onshore bond market today? (1 for MOST concerned, 5 for LEAST concerned)**

Answer Options	1	2	3	4	5	Don't know
Value of the RMB	32%	32%	24%	4%	3%	5%
Default rate of Chinese corporates	23%	33%	20%	15%	3%	7%
Leverage of Chinese corporates	15%	41%	27%	7%	4%	7%
Availability of RMB (offshore/onshore)	27%	20%	33%	9%	4%	7%
GDP growth	9%	17%	37%	21%	7%	8%
Clear and stable government policy on financial markets	36%	39%	17%	3%	0%	5%
Property market prices	7%	16%	29%	27%	13%	8%

6. **How important are the following capital market development concerns when you consider investing in China's onshore bond market today? (1 for MOST concerned, 5 for LEAST concerned)**

Answer Options	1	2	3	4	5	Don't know
Inclusion in global bond indices	27%	34%	26%	5%	4%	4%
Availability of hedging instruments such as access to onshore FX forwards, futures, CDS and IRS markets	26%	39%	26%	3%	1%	5%
Corporate governance	28%	38%	20%	5%	3%	5%
Free flow of capital cross-border	36%	36%	20%	3%	0%	4%
Liquidity in secondary bond market	41%	34%	18%	3%	1%	4%
On-the-run benchmark yield curve	4%	46%	42%	1%	1%	5%
Market driven interest rates	12%	45%	34%	3%	1%	5%
Access for foreign underwriters to the primary market	5%	32%	39%	14%	4%	5%
Established classic "true sale" repo market	5%	31%	38%	11%	8%	7%
Wide and diversified investor base	11%	26%	41%	14%	4%	5%
Range of products available for foreign investors	15%	32%	41%	3%	5%	4%
Availability of documentation and regulations in English	22%	31%	26%	5%	11%	5%

7. **How important are the following credit information concerns when you consider investing in China's onshore bond market today? (1 for MOST concerned, 5 for LEAST concerned)**

Answer Options	1	2	3	4	5	Don't know
Coverage of issuers by international credit rating agencies	26%	41%	22%	1%	5%	4%
Availability of international ratings at bond instrument level	29%	36%	25%	3%	4%	4%
Differentiation within domestic rating scales	14%	38%	30%	5%	3%	10%
Availability of credit information offshore (e.g. from information providers) on China market	29%	41%	18%	4%	4%	4%

8. **How important are the following legal and operational concerns when you consider investing in China's onshore bond market today? (1 for MOST concerned, 5 for LEAST concerned)**

Answer Options	1	2	3	4	5	Don't know
Clarity on withholding tax and VAT regime	46%	32%	14%	1%	1%	4%
Free repatriation of invested funds	55%	28%	13%	0%	0%	4%
International settlement cycle	27%	38%	27%	4%	0%	4%
Clear beneficial ownership rules	48%	28%	18%	1%	0%	4%
Recognition of close out netting and clear bankruptcy default mechanism	32%	38%	18%	4%	0%	7%
Clear and feasible KYC rules for establishing relationships with counterparties	24%	39%	25%	6%	0%	6%
Freedom to use trading and settlement infrastructure that is integrated with global markets	30%	41%	24%	1%	0%	4%
Availability of offshore settlement	15%	34%	34%	10%	3%	4%
Availability of nominee/omnibus account structures	20%	30%	32%	7%	3%	8%

9. **Of the sets of factors listed in the 4 questions above, please rank the importance of these concerns to you from 1 to 4 (1 for MOST important, 2 for SECOND MOST important, 3 for SECOND LEAST important, 4 for LEAST important)**

Answer Options	1	2	3	4
Macro-economic concerns	27%	18%	26%	29%
Capital market development concerns	31%	32%	24%	13%
Credit information concerns	15%	19%	39%	27%
Legal and operational concerns	27%	31%	11%	31%