Chinese Bond Connect puzzle slowly unlocking

Foreign investment continues to accelerate as the government rolls out new measures, but many still fear making a leap into the unknown.

By FinanceAsia Editors

30 October 2018

The opening up of China's $12 trillion domestic bond market is arguably the most important event for the global bond market this century. At some point, fund managers know they will need to engage with, or at least understand, the world's third largest bond market.

Many have already dipped their toes in the water. In July, foreign holdings of Chinese government bonds (CGBs) topped Rmb1 trillion ($146.26 billion) for the first time. During the first half of the year, foreign investors became the single biggest buyers for CGBs and now account for 8% of all holdings.

Demand has also increased month-on-month for the past 18 months, even as the renminbi began its slide against the US dollar. Brokers expect this pattern to continue.

Goldman Sachs, for one, predicts inflows of $1 trillion into China's domestic bond market over the next five years. It expects $700 billion to $800 billion to pour into CGBs with the remaining $250 billion-odd into policy bank and corporate bonds.

The headline numbers look great, but do they tell the full picture about a market where overall foreign holdings still make up less than 2%?

In *FinanceAsia*'s **inaugural Bond Connect survey**, we asked investors about key issues surrounding the market and **Bond Connect**, the market access scheme established by the China Foreign Exchange Trade System (CFETS) and Hong Kong Exchanges and Clearing (HKEX).

This trading link, which mirrors an existing Stock Connect scheme, enables offshore investors to buy and sell the full gamut of bonds traded on China's interbank market through Hong Kong. It means that foreign investors do not need to set up an account on the Chinese mainland and can use their offshore banks to execute trades.

Since the scheme was **launched in July 2017**, the government has also rolled out a series of measures to improve its efficiency and usability.

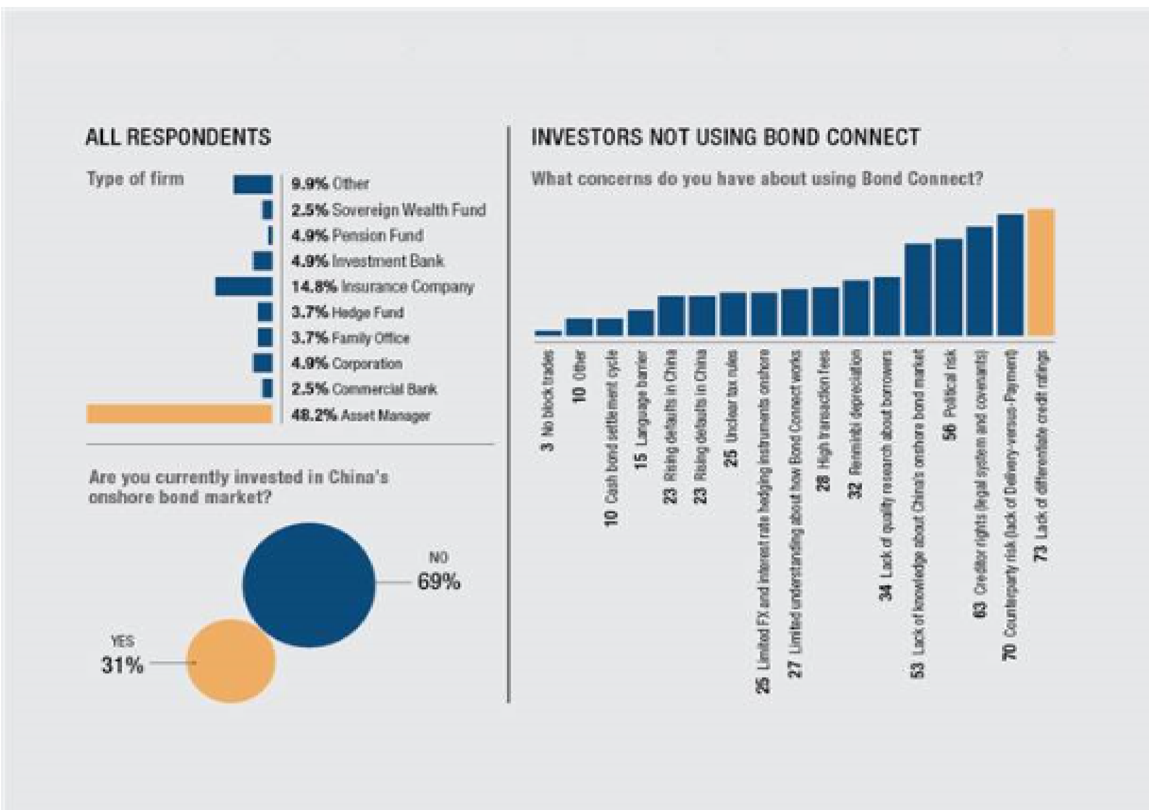
In particular, the government needed to make three adjustments to fulfil the inclusion criteria for CGBs and policy bank securities in the Bloomberg Barclays Global Aggregate Index. China is scheduled to be included from next April and this should result in inflows of $137 billion once the country reaches its full index weight of 5.49% after a 20-month scaling-in period.

The first and most important adjustment was the introduction of a real-time delivery-versus-payment (DVP) settlement system for transactions through Bond Connect in late August. This represented a major step in reducing settlement risk for offshore investors. It had been a major barrier that prevented European Undertakings for Collective Investment in Transferable Securities (UCITS) from using Bond Connect.

The second adjustment concerned block trading, which was opened up to foreign investors on August 30. On the same day, the State Council also addressed the third issue and announced a three-year moratorium on both income tax and value-added tax for foreign investors on the interest income their bonds generate.

Other index providers are also expected to include China within the next couple of years, most notably the FTSE World Government Bond Index (FTSE WBGI), which has a tracking Assets Under Management (AUM) of $2.5 trillion and the JP Morgan Government Bond Index - Emerging Markets (GBI-EM), which has a tracking AUM of $220 billion.

HSBC estimates that China is likely to be given a 5% weight in the former, potentially leading to $125 billion of inflows and a 10% weight in the latter, equating to $22 billion inflows.



STILL UNDERINVESTED

Yet the picture which emerges from *FinanceAsia*'s survey, shows an investor base fearful of a market it feels it does not really understand. A total of 400 investors are approved to use the Bond Connect scheme.

Just over 90% of respondents in the survey are based in Asia, with the largest portion (33.3%) in Hong Kong. Nearly half are asset managers (48.1%), followed by insurance funds on 15%.

In broad terms, they are fully aware of China's growing importance to global capital markets, but many are still held back by a perceived lack of information about it. That primarily covers undifferentiated credit ratings, the single biggest concern for investors whether they are using Bond Connect or not.

And then there is the issue of the Chinese language, cited time and again as a barrier by respondents. This is undoubtedly one of the reasons why roughly three-quarters of non-Bond Connect users feel they do not have enough information to make sensible judgments.

Unsurprisingly, 79.2% of respondents, who do not use Bond Connect, feel that the entry barriers to access are either: high (41.9%), very high (23.3%) or insurmountable (14%).

"Historical access limitations mean that foreign investors hold a relatively tiny portion of the market," Bryan Collins, head of Asian fixed income at Fidelity International, told *FinanceAsia*. "China Interbank Bond Market (CIBM) Direct and Bond Connect are closed loop and not fungible, i.e. if you buy a bond through CIBM, it is only possible to sell the same security through CIBM and not Bond Connect."

Foreign investors, who were first allowed to tap China's interbank bond market in 2012 through the quota-based Qualified Foreign Institutional Investors (QFII) scheme and the renminbi version of that, the RQFII, currently hold about 2% of all Chinese bonds, according to official data. Even with the introductions of CIBM Direct (for institutions deemed eligible by the People's Bank of China) in 2016 and Bond Connect the following year, the two QFII channels remain the most popular way for foreigners to buy and sell Chinese bonds, according to fund managers.

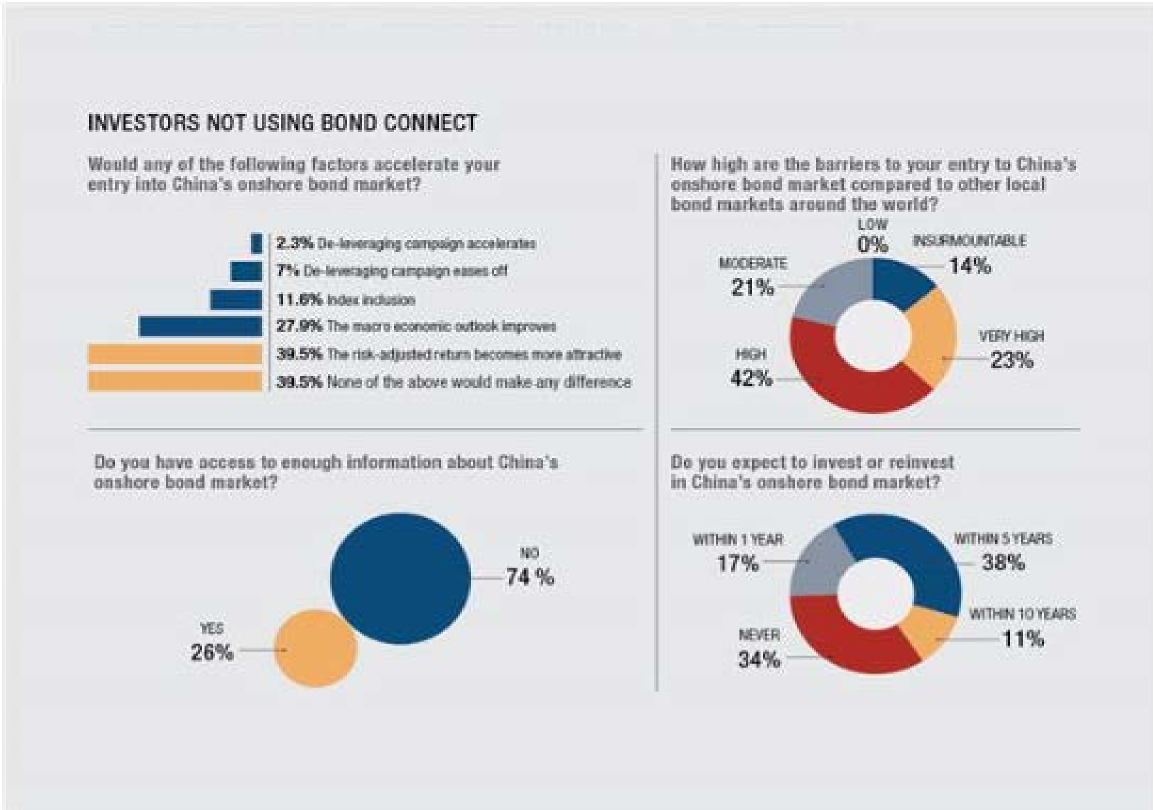
For David Yim, head of Great China debt capital markets at Standard Chartered, the main issue that inhibits greater foreign participation in China is not the market plumbing but rather a lack of underlying investment opportunities.

"The hardware such as channels into China and trading facilities is ready for foreign investors, but what's missing are a lack of investable bonds," he said.

Yim said that foreign investors, at least currently, are only interested in safe-haven assets such as CGBs or debt issued by policy banks such as China Development Bank. He said they remain sceptical about onshore corporate bonds, which do not offer enough of a yield pickup over sovereign bonds to compensate for the added and potentially unquantifiable risk.

"In short, I think that the lack of liquidity in the onshore market and hedging tools, as well as distrust of the local rating agencies, are the major hurdles to get foreign investors into the domestic China market," Yim concluded.

The survey data backs this up, with respondents suggesting that the participation of retail investors, similar to Stock Connect, could help to boost liquidity.



Tomorrow we will publish the second part of FinanceAsia's *inaugural bond connect survey, revealing some of the obstacles bond investors face when investing in the onshore bond market.*

If you are interested to receive the full report or more information, please contact **Keith Frith**, Commercial Director, *FinanceAsia*.

Global ambitions: Yuanta Securities eyes opportunities for worldwide growth

As a pioneer in wealth management among Taiwan's securities firms, Yuanta Securities now holds top spot in this market. In a conversation with FinanceAsia, Yuanta's executive vice president Tony Wang and Sharon Chen, CEO, Yuanta Securities (Hong Kong) explain why demand for its services is on the rise.

By Yuanta Securities

18 October 2018

As a wealth manager Yuanta Securities (Yuanta) dominates its home market where it controls 36.37% of this sector. Holding the lion's share of Taiwan's local securities industry makes it the go-to brokerage for retail clients.

As of the end of June 2018, the firm had assets under management (AUM) of NTD45.15 billion ($1.46 billion).

This year, this stand-out success was recognised by FinanceAsia editors who awarded the firm - Best Broker - in the prestigious and long-standing Country Awards for Achievement 2018.

Yuanta Securities obtained approval for its wealth management business in 2011 and the firm's overseas expansion began with a series of M&A. These included the 2014 purchase of a 53.1% equity stake of TONGYANG Securities (now known as Yuanta Korea) and the acquisition of PT AmCapital Indonesia (now PT Yuanta Securities Indonesia) in 2015.

In 2016, it acquired KKTrade Securities (renamed Yuanta Thailand). In the same year the firm restructured its 147 traditional brokerage branches, turning them into comprehensive wealth management branches. This strategic move resulted in profits increasing by 40%, over and above 2015 results.

The firm became a majority stakeholder (99.95%) in The First Securities Joint Stock Company (renamed Yuanta Securities Vietnam Joint Stock Company) in 2017.

By 2017, 15% of Yuanta's total income was created by foreign subsidiaries, further highlighting the company's efforts to diversify income and its internationalisation plans.

Q: *What steps are you taking to become the best financial services provider in the Asia-Pacific region?*

Tony Wang

Tony Wang: Like our securities peers, we recognise the need for globalisation. Yuanta is the most aggressive among domestic competitors and we compare favourably to other regional securities firms.

We operate in Hong Kong, Thailand, Vietnam, Korea, Indonesia, Cambodia and mainland China and we are building our Hong Kong subsidiary as a financial hub to connect markets in Taiwan, Korea, Thailand, Vietnam and Indonesia, and we're developing products and platforms to amplify our advantage of cross-borders financing.

So we have already started on the journey to become the best financial services provider in the APAC region. If we can leverage our group resources and consolidate local intelligence from our subsidiaries, we believe we can create more synergies together.

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Q: *How does Yuanta Securities Hong Kong (YSHK) integrate into the business and how do you attract cross border transactions and global clients.*

Sharon Chen: Yuanta Securities has restructured our overseas platform to accelerate and deepen our regional reach with YSHK as our Asian hub.

Hong Kong attracts high levels of inbound and outbound investment, it's also the gateway to mainland China, and a regional financial hub. Low-tax rates, a well-established financial infrastructure and a free market makes Hong Kong attractive to potential investors. YSHK endeavours to serve local clients as well as clients from our group's extensive network.

We believe our clients want their private wealth to be managed holistically, therefore our team of professional wealth managers provides a variety of investing strategies that meet the needs of individual clients.

Sharon Chen

Q: *How do you customise and tailor wealth management plans to meet individual client needs?*

Tony Wang: Taiwan is facing a rapidly aging population, so for these clients, we focus mainly on retirement, long-term care and tax planning. We divide clientele into nine groups, sorted by high, middle and low income and this is cross referenced with elderly, middle-aged and young age groups.

Our sales representatives and a 200 strong team of wealth management professionals work together to build customised plans for clients. Yuanta's unique service combines stock investment and cash-flow creation for each client.

Our goal is to custom-build a complete wealth management plan for each customer. For example, high net worth clients aged between 65-75 are concerned about inheritance and daily cash inflows.

Both Yuanta Securities and Yuanta Insurance work together to help clients see inheritance as an opportunity, and we help our clients with appropriate arrangements for life insurance and trust instruments denominated in foreign or Taiwanese currencies. Clients can also invest in inheritance insurance that provides benefits in 10-20 instalments with our customised insurance plan.

Client aged between 40-50 are more focused on family medical insurance. Our trusted relationship with our clients means Yuanta's care plans support their needs for long-term disability and unlimited medical insurance for specific injuries.

Our clients become like family. When setting up their financial plan, we not only care for each individual client, but also their whole family. Words gets around, and we are most satisfied when a high-end client refers friends to us. This proves we've done our job right.

Q: *What do you see as the firm's keys to success?*

Tony Wang: Our people are the keys to our success. Yuanta started as a local broker but we now have around 7,400 employees worldwide. We believe in cultivating talent and that's been an important part of our company's history for the past 50 years. It is also one reason why we have become the largest broker in Taiwan.

And we're also looking to the future. In 2008, we initiated an MA program to cultivate our future management team and we have a complementary plan for key talent development as part of our overseas expansion.

More information about Yuanta Securities is available **here**

Settling for more

Stock exchanges find novel uses for blockchain

Australia, Singapore and Switzerland are among those experimenting with cryptotechnology

Economist | Finance and economics

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Blockchain, the technology underlying bitcoin and other cryptocurrencies, was designed with an ideological aim: to sidestep central authorities and governments. But many people have become intrigued by its practical uses, such as updating back-office processes. And few institutions have shown more interest in such applications than financial exchanges.

Although stock trades are often made in milliseconds by algorithms, completing them involves co-ordinating payment and delivery among a mess of databases and then reconciling the records. In big financial centres trades take two full days to settle. Some stock exchanges wonder whether blockchain's distributed, tamper-proof ledgers and immutable and transparent transaction records could speed up and simplify the process.

Exchanges from America and Australia to Switzerland and Singapore are studying the concept. Australia's stock exchange, the ASX, has moved furthest towards using blockchain to replace its main clearing and settlement platform. It has been testing technology from Digital Asset, an American firm, and will go live in mid-2021. And on November 11th SGX, Singapore's stock exchange, and the Monetary Authority of Singapore (MAS), its central bank, announced a prototype using blockchain for delivery, payment and settlement of assets.

These projects are strikingly unlike the vision of blockchain enthusiasts. ASX's, for example, uses ledgers but remains quite centralised. A single counterparty, ASX itself, must approve participants (which removes the need for energy-intensive verification and updating of records, as with bitcoin). Though open to all, only some banks and brokers will opt for direct access. Everyone else must trade through them. In contrast to the complete transparency of the bitcoin ledger, market participants will not have access to the whole dataset (for legal reasons, but also so they do not have to give away their positions). And settlement will not be in real time.

Why, then, bother? Kelly Mathieson of Digital Asset says her firm's purpose-built programming language, DAML, which enables financial contracts to be automated, will make further innovation easy. The tedious processes of reconciliation, she says, will be drastically simplified.

As soon as next year investors will be able to see the result of another, smaller experiment. SIX, the owner of the Swiss stock exchange, will launch a separate digital platform for trading assets, such as stocks and bonds, in “tokenised” form—that is, in a format blockchain can handle. Tokenising will eliminate minimum trade sizes, says Thomas Zeeb of SIX. It will also make a much wider range of assets tradable. Mr Zeeb has already been approached by a museum that wants to tokenise its art collection, as a novel source of funding. Investors would gain exposure to the value of the art going up or down through such tokens, which they could trade.

All these projects have, or plan to obtain, official blessing; after all, exchanges are highly regulated. But the Singaporean project shows the value of seeking more than a nod of approval. MAS’s involvement meant the prototype did not limit itself to stock trading or settlement, but also looked at digital currency issued by the central bank. Quite a turnaround for a technology designed to circumvent governments.