

# Understanding RMB Liquidity

## *The investment case, challenges and changes*

May 2019

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# China's money market funds

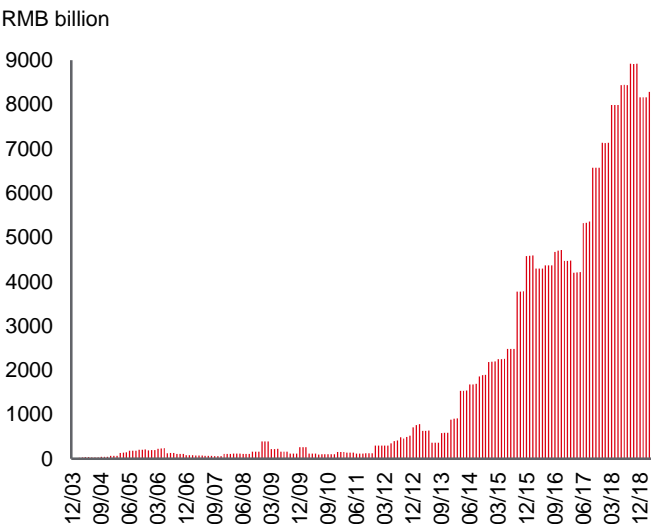
## A large and evolving market

China's money market fund industry has come a long way, in a very short amount of time. Within 10 years, total assets in money market funds have gone from less than RMB 300 billion to RMB 8 trillion (USD 1.2 trillion) today. The asset class was thrust forward in 2013, when an internet fund linked to a third-party payment platform burst into the scene, dominating the market and starting a new wave of online money market funds. Retail investor interest in money market funds was intensified largely due to developments in China's e-commerce and internet finance platforms, which made accessibility to money market funds easier. Expansion of the industry during the 2013 period was primarily driven by retail investors, but over the years that followed, institutional assets also poured into the asset class. Today, institutional investors make up one-third of the current investor base in China's money market funds.

Money market funds are a significant component of the mutual fund industry in China, making up a staggering 60% of the total. Such a composition is vastly different from Europe and the US, where equity mutual funds dominate the mutual fund industry. Beyond the domestic markets, China's money market fund industry has grown to be the second largest in the world.

One single and dominant fund in the industry, that had entered the scene in 2013, had grown so rapidly and had reached USD 270 billion in size at its peak in March 2018, representing about 20% of the asset class. But the size of this fund has since shrunk as it experienced outflows, largely attributed to the fund manager's actions to lower concentration risk. This corresponds to the regulatory developments that have taken place in the money market industry; alongside the expansion seen between 2013 to 2018, concerns of concentration risk, liquidity risks, potential systemic risk and issues around transparency have transpired and regulators have stepped in to issue new rules in order to curb growth and protect investor interest. While the new rules are effectively creating a higher entry barrier and causing a disruption for certain products, they do imply a strategic advantage for funds that are operating by global standards and adopting a balanced approach of aiming to preserve capital, manage risks, and provide liquidity, along with focusing on yield.

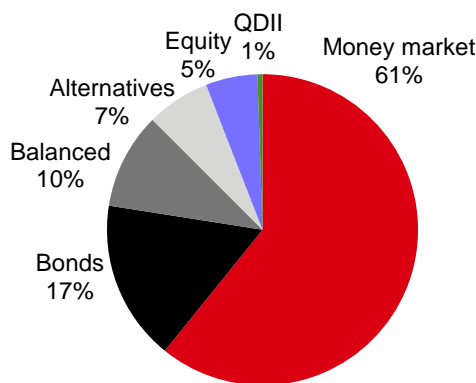
### China's money market funds – sharp growth from 2013



Source: Asset Management Association of China, Wind, as of March 2019

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### Money market funds make up 60% of China's mutual fund industry



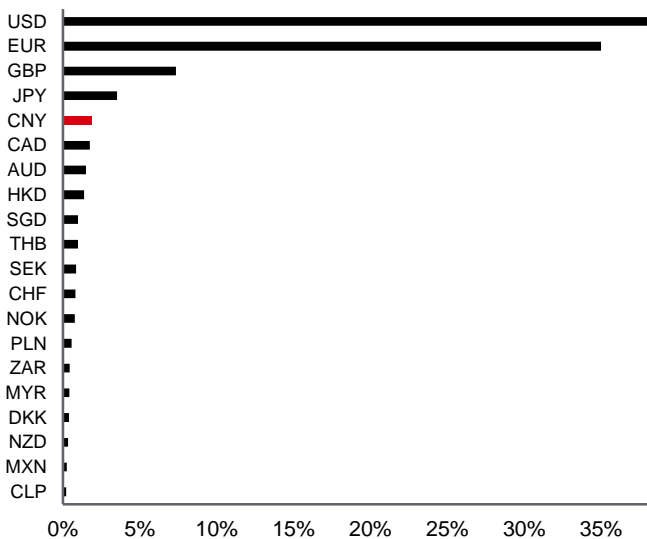
# Themes for RMB liquidity – Demand for the RMB

## Demand for RMB liquidity

- ◆ A number of catalysts are in place to enable faster growth of RMB usage internationally, including the emergence of a cashless society with digitalization and mobile services that expand RMB usage, benchmark inclusion of onshore equities and bonds, progress of China's Cross-border Interbank Payment System (CIPS) and greater use of the RMB in commodity trading
- ◆ Commercial banks outsourcing liquidity management to asset managers as well as foreign companies in China requiring RMB liquidity solutions are adding to the institutional growth in the money market industry
- ◆ China has been steadily opening up its capital markets to foreign investors, and major global index providers have been making significant changes to include domestic RMB assets into their widely tracked indices
- ◆ These changes are expected to drive hundreds of billions of dollars of inflows into RMB assets
- ◆ The opening up of Chinese bond markets would translate to increased allocations by global FX reserve managers to RMB assets

### RMB is the 5<sup>th</sup> most active currency for domestic and international payments

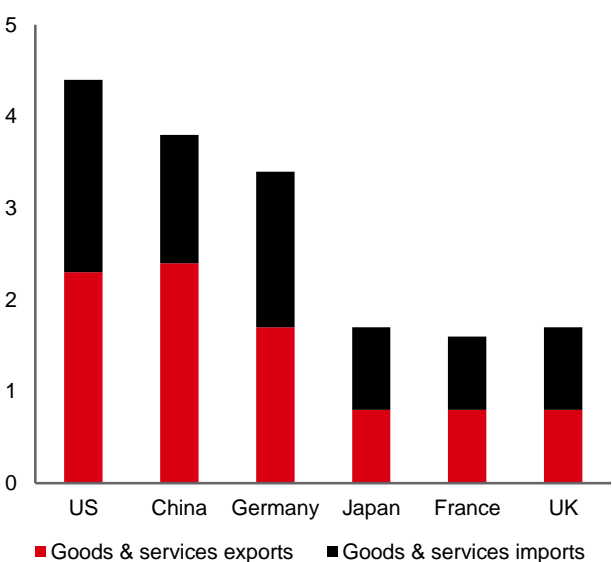
Currency share of total domestic & international payments (Feb 2019)



Source: SWIFT, Bloomberg, CEIC, HSBC Global Asset Management, as of February 2019

### RMB internationalisation is supported by China's growing weight in global trade

USD billion (2013-2017 average of select countries)



### Index inclusion to drive inflows into RMB assets

Global Index	Asset class	Time period	Estimated inflows into RMB assets
Bloomberg Barclays Global Aggregate	China onshore RMB bonds	Phased-in inclusion in April 2019 to November 2020	+USD 150 billion
MSCI Emerging Markets & other MSCI indices	China A-share equity	May 2019 – November 2019	+USD 70 billion

Source: Bloomberg, HSBC Global Research as of April 2019

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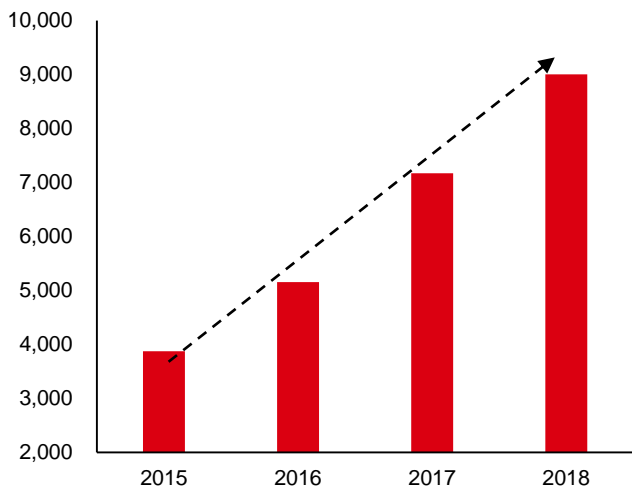
# Themes for RMB liquidity – Strong digital economy

## A strong digital economy is supportive of continued retail flows

- ◆ E-commerce growth and related technological advancements have been fundamental to the massive inflows into money market funds. Retail investors were able to invest miniscule amounts into such internet funds – this would have been previously unfeasible
- ◆ China's dominant money market fund, with AUM of around USD 150 billion (as of March 2019) is operated by a Chinese e-commerce platform operator

### China's online retail sales seeing steady growth

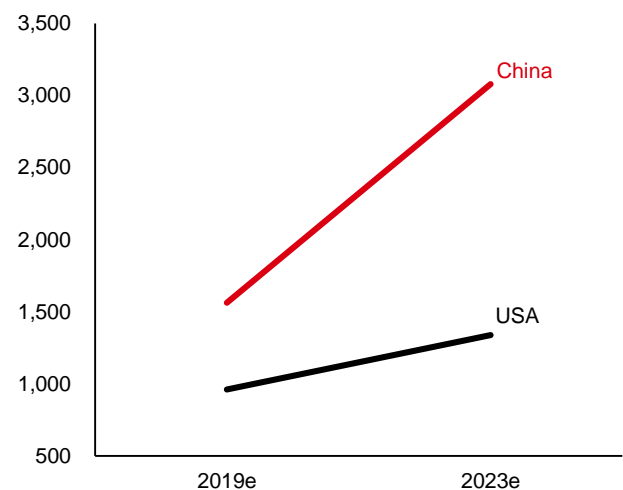
Online sales in RMB billion



Source: National Bureau of Statistics PRC as of April 2019

### Digital payments expected to continue to grow

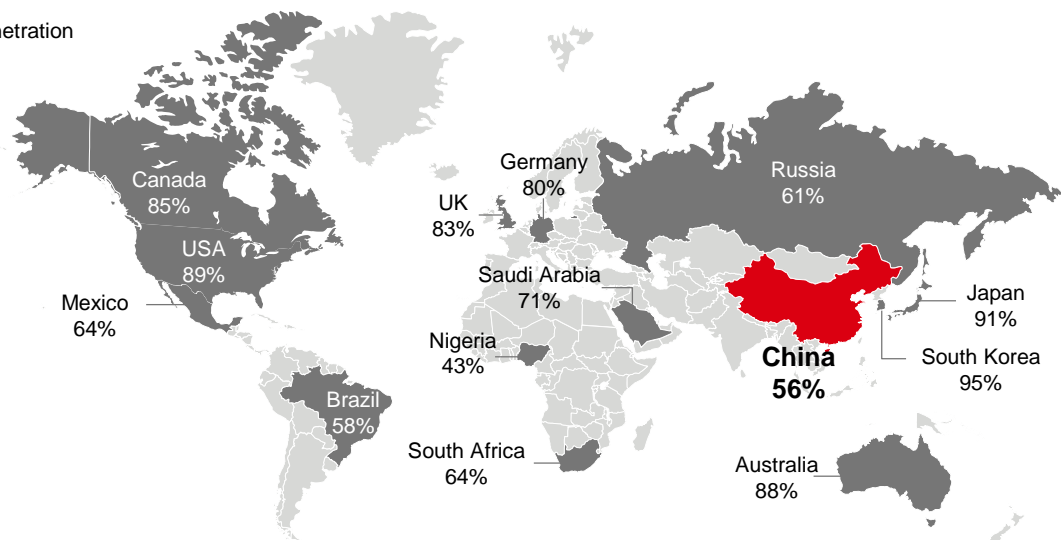
Transaction value in digital payments, estimated (USD million)



Source: Statista as of April 2019

## Still relatively low internet penetration in China indicating further growth potential

Internet penetration



Source: Statista as of January 2019

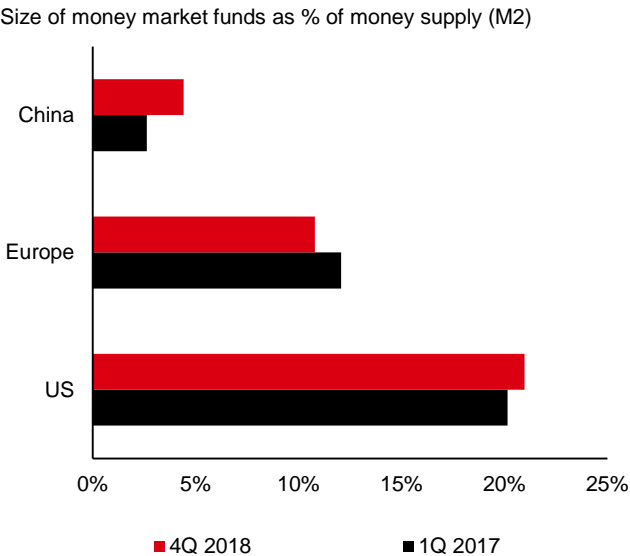
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# Potential for further growth

## Growth potential still exists for the Chinese money market fund industry

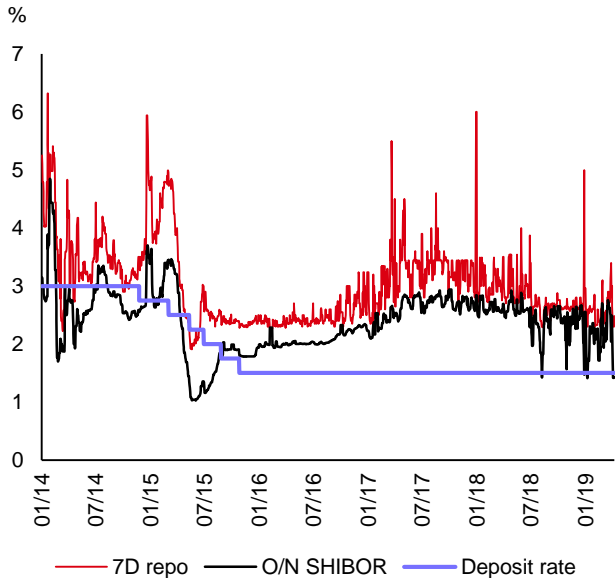
- ◆ Although the RMB money market fund industry has seen substantial growth over the years, it is worth noting that the total size of its assets makes up only 4% of China's money supply (M2). This is much lower than corresponding data from the US and Europe
- ◆ There is plenty of room to grow with domestic investors gradually adopting money market funds as a lower-risk alternative to equity or fixed income funds and potentially higher-returning option to traditional deposits

### RMB money market funds make up a small portion of broad money



Source: Bloomberg, ICI Worldwide Market Data, HSBC Global Asset Management, as of March 2019

### Money market funds are good options for yield and daily liquidity



Source: Bloomberg, AMAC, as of April 2019



# Factors unique to RMB money market funds

## 1. Supported by regulatory regime

- ◆ Regulations limit the interest that banks can pay on deposits and require them to place part of the deposits with the central bank to meet the reserve requirements
- ◆ This has prompted investors to look for alternative investment products such as money market funds. While the central bank has relaxed the upper limit on bank deposits for some commercial banks, deposit rates are still controlled

## 2. Investor flows and concentration

- ◆ Unlike global investors, who are likely to invest in money market funds for targeting capital preservation and for daily liquidity, Chinese investors primarily expect their money market fund investments to offer attractive yields
- ◆ Prior to 2017, there were no rules on investor concentration, leading to the formation of a number of funds with a single, large institutional investor. These funds face significant liquidity risk
- ◆ However, new rules introduced in 2017 require funds to have higher liquidity and shorter duration should they have higher investor concentration (see page 8)

## 3. Liquidity with loose restrictions

- ◆ Chinese regulations currently allow money market funds to have longer weighted average maturities and weighted average lives than their global counterparts
- ◆ This increases the liquidity and credit risk inherent in RMB money market funds as they seek exposure to longer duration assets
- ◆ The issue is compounded by limited daily liquidity thresholds and smaller weekly liquidity requirements, especially when compared to regulations in the US and EMEA

## 4. Funds' ratings and portfolio quality

- ◆ Many RMB money market funds employ leverage, invest in less liquid and lower quality assets, or concentrate their holdings to improve yields
- ◆ Of all the money market funds available in China, there are only three funds, all run by joint ventures with international asset managers, that are currently rated by global rating agencies
- ◆ Many funds market themselves as low risk but invest in a wide variety of assets. This practice would not be allowed in more developed markets globally

Source: Bloomberg, CSRC, HSBC Global Asset Management, as of March 2019

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# Regulatory developments

## Convergence of regulatory standards

- ◆ The increasing size and influence of the industry and the relatively lax regulatory environment have prompted the China Securities Regulatory Commission (CSRC) to issue rules in 2017, targeting investor concentration, disclosure requirements, and risk provisions. These rules strengthen guidelines on the liquidity management, particularly within institutional money market funds with concentrated investor bases
- ◆ Further, in 2018, rules were introduced to cap daily redemptions to RMB 10,000 for T+0 redemptions. While this is not an attractive proposition for institutional investors with large ticket sizes, this does tackle the issue of liquidity risk in times of market stress, given that the average holding per investor was found to be RMB 10,000
- ◆ Regulatory developments are a significant step forward towards harmonising the policies in China with global principles around sound liquidity management
- ◆ New funds with single investor holding exceeding 50% of the fund are subject to valuation at market-to-market or holding of 80% or more in liquid assets. Regulatory tightening has brought new fund launches to a halt and non-compliant funds to close down, with the number of money market funds retreating from 395 at the end of 2017, to 381 at the end of Q1 2019

## Timeline

2015

### Money market fund guidelines:

- ◆ Established daily liquidity minimum of 5% and weekly liquidity minimum of 10%
- ◆ Reduced the maximum fund leverage allowed to 20%
- ◆ Tightened limits on weighted average maturity and weighted average life

2017

### Liquidity risk management for mutual funds:

- ◆ Funds with higher investor concentration are subject to higher liquidity and shorter duration requirements
- ◆ New funds with single investor holding exceeding 50% are subject to asset valuation at mark-to-market or holdings of 80% liquid assets
- ◆ Disclosure requirements and risk provisions

2018

### Redemption rules:

- ◆ Rules were introduced to cap daily redemptions to RMB 10,000 for T+0 redemptions

## China money market funds governed by less stringent policies than global counterparts

	US	EMEA	China If weight of top 10 investors is above 50%	China If weight of top 10 investors is between 20% and 50%	China If weight of top 10 investors is below 20%
Max WAM <sup>1</sup> (days)	60	60	60	90	120
Max WAL <sup>1</sup> (days)	120	120	120	180	240
Leverage	N/A	N/A	20%	20%	20%
O/N liquidity	10%	10%	5%	5%	5%
1 week liquidity	30%	30%	30%	20%	10%
Fees	Yes	Yes	1% <sup>2</sup>	1% <sup>3</sup>	1% <sup>3</sup>
Fees waiver	Yes	Yes	Yes	Yes	Yes

Notes:

1. WAM = weighted average maturity; WAL = weighted average life

2. 1% Discretionary liquidity fee on the redemption amounts above 1% if 1. Weekly liquidity is below 10% and 2. MTM NAV vs Amortised cost is negative

3. 1% Discretionary liquidity fee on the redemption amounts above 1% if 1. Weekly liquidity is below 5% and 2. MTM NAV vs Amortised cost is negative

Source: Bloomberg, CSRC, HSBC Global Asset Management, as of March 2019

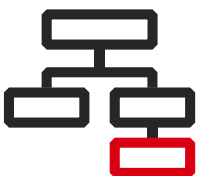
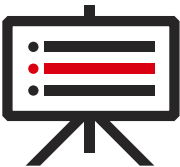
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# Why a transparent, risk-focused, balanced approach to managing RMB money market funds is a strategic advantage

## Transparency:

One of the goals of the evolving regulatory landscape is to provide investors with more information on how funds operate and the potential risks. Increased transparency will enable investors to make more informed choices



## Sound risk management:

Instead of using yield as the only criterion, it is crucial to take portfolio risk into consideration by monitoring overall liquidity and credit risk, and ensuring that **clients' capital is shielded from market downturns**

## Balanced approach:

New regulations may lead to the closure of single investor funds and establish a higher entry barrier. As the market evolves, investors would learn to prioritise the target of capital preservation and liquidity, along with yield.



## Following global standards:

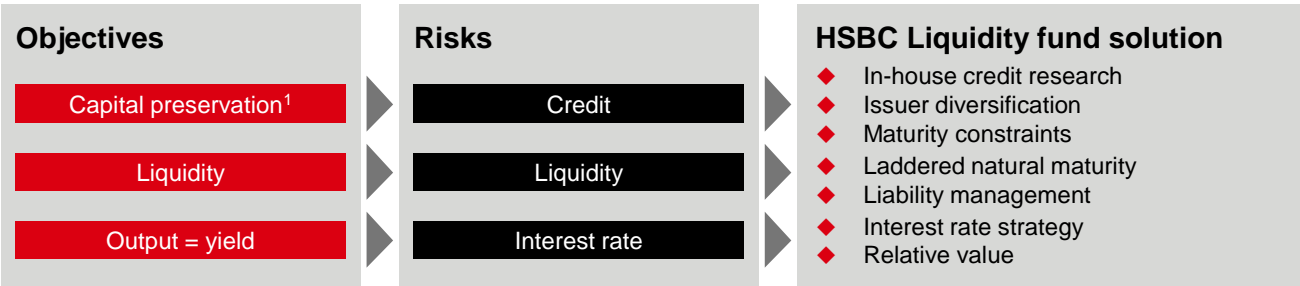
Regulatory changes in China imply a strategic advantage for funds that are rated by international agencies, abide by global standards, and continue to focus on their strategy in a dynamic market environment.

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# Why HSBC as your liquidity partner?



## Disciplined investment process to fulfill clients' objectives



Note 1: There is no guarantee that a stable net asset value will be maintained. Investors may not get back the amount originally invested. There is no guarantee that the fund's investment objectives, including performance, will be achieved.

Source: HSBC Global Asset Management, data as of March 2019

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# HSBC RMB liquidity strategy



## Rated AAmmf(chn) by Fitch Ratings

HSBC Jintrust Money Market Fund is one of the three MMFs that are currently rated by Fitch Ratings

## Well-positioned for new regulatory regime in China



	China	HSBC Jintrust MMF
Max WAM (days)	120	75
Max WAL (days)	240	90
O/N Liquidity	5%	20%
Weekly Liquidity	10%	30%

Fund details	HSBC Jintrust MMF
Fund inception date	2 November 2011
Fund size	RMB 14,164 million (as of 31 May 2019)
NAV of Class A & Class B	RMB 1.00 (constant)
Benchmark	RMB 7-day call deposit rate (after tax)
Base currency	RMB
Dealing date	T Day
Settlement date	T+1 Day
Dividend distribution	Daily dividends; Monthly payments
Weighted average maturity (days)	56
Weighted average life (days)	56

Source: HSBC Global Asset Management, data as of 31 May 2019

## Contact us to find out more

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