



Opalesque Roundtable Series '16

CHINA

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Editor's Note

From "Famine of Assets" to Internationalization: China may change faster than many think

When the Chinese stock bubble burst in 2015, instantly a buzzword called the "Famine of Assets" was coined, referring to the phenomenon of too much money chasing only a few "good" assets. Immediately after the stock market crash, China ran into a bond market bubble, an on-going real estate bubble and arguably a private equity bubble... Why? As anywhere else, China has too much liquidity and a lack of quality investable assets for Chinese investors, individuals and institutions alike.

The problem is not just about quality but also the scale. *People tend to think about China as an over-leveraged country, but it's actually an over-saving nation as well.* The total savings deposits are estimated at around US\$25 trillion, and savings rates are normally 50% of the GDP. The Chinese economy is slowing down but still growing, so in absolute terms, the savings continue to grow significantly year after year. In contrast, the domestic bond market is "only" around US\$7 trillion, most of which is inaccessible by individuals. The domestic equity market is also around US\$7 trillion, but about 65% of that is owned by the government and locked away. The investable free float is only 35% or just shy of US\$2.5 trillion.

So the bond market may be too small. The equity market may be too "risky". Real estate investment is off limits due to the numerous restrictions in place to cool off the market. Capital control is getting tighter by day and thus no money can leave the country easily. Meanwhile the rates are coming down and the currency is depreciating... *Whether you are a wealthy individual, a large corporation or a financial institution in China, all are facing the same problem: where do you put your money?*

Chinas has 50 million private companies, and many do grow with CAGR of over 30%

There are 50 million private companies in China, and many do grow with CAGR of 30% plus. The question is if you are able to identify them? If you do **venture capital** in China, your biggest competitors are not just other VC firms, but BAT, which are Baidu, Alibaba and Tencent, and plus countless entrepreneurs and traditional business people who want to get into this field. Yes, there is a lot of innovation happening in China, but it can't catch up with the growth in the so-called "excess capital".

But again, there are still a lot of interesting opportunities in China. It's a big country and has many regional or structural imbalances that will continue to offer investment opportunities. At the same time, it appears that this is the first time in the last few decades that China faces both economic slowdown and currency depreciation simultaneously. Probably the only way to further normalization is to continue opening up the markets.

The importance of global diversification

Both Chinese individuals and institutions have increasingly realized the importance of diversification, and specifically global diversification. If you went to a Chinese company ten years ago and said you wanted to help them invest abroad, you would have probably been instantly shown the door because there was no need to look for any other growth outside of China. The change has been in both directions, with capital leaving and going into China. The Chinese regulator made it very clear they want to open the market not just for more foreign ownership, but particularly institutional ownership. All of that could happen faster than people think.

The Opalesque 2016 China Roundtable, sponsored by Eurex and WTS, took place in Shanghai with:

1. Ms. Connie Lee, [WTS](#)
2. Qi Wang, [Mega Trust](#)
3. Roland Schwinn, [Eurex](#)
4. Michael Hsih, [Deutsche Börse](#)
5. Ming Pan, [GTJA-Allianz Fund Management](#)
6. Barry Lau, [Adamas](#)
7. Andy Mantel, [Pacific Sun](#)
8. Steffen Gnutzmann, [WTS](#)

The group also discussed:

- Why a manufacturing slowdown doesn't necessarily equate to an overall decline (page 8)
- The three main China policies: "One Belt, One Road" initiative, RMB Internationalization, Made in China 2025 (page 8, 14)
- Special situations using a private equity style approach (page 9, 12)
- Investing in China on the private credit side - the better option? Funding gap estimations reach from US \$1 tto \$7 trillion (page 11- 12)
- How to minimise the currency risk (page 12-13)
- What is the situation with non-performing loans or NPLs? (page 11, 26)
- Where is China's legal system today? (page 11)
- How new PRC tax rules impact private equity funds (page 27)
- What is Frankfurt based CEINEX (China Europe International Exchange) offering? (page 14)
- How to do fundamental research in China: Why the traditional Western metrics don't work here, and what to do instead (pages 16-19)
- MSCI's review in June 2017: Inclusion of China A-shares will lift China to 50% of emerging markets, inflows of \$640bn expected (page 20)
- When will overseas investors be able to directly invest in China? (page 19-22)
- The situation of institutional investors in China (page 22)
- How did the clean up of 30,000 so-called sunshine funds (private funds) to now 7,000 affect the industry? (page 23)
- The role of foreign competition for the China private fund industry (page 24)
- Misperceptions about China's economic situation (page 24-26)
- How China is pioneering financial inclusion and robo-advisory (page 26-27)

Enjoy!

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Participant Profiles



(LEFT TO RIGHT)

Ming Pan, Roland Schwinn, Michael Hsih, Barry Lau, Qi Wang, Connie Lee, Steffen Gnutzmann, Andy Mantel, Matthias Knab

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Introduction

Roland Schwinn

Eurex

My name is Roland Schwinn. I represent Eurex, the derivatives market of the Deutsche Börse Group, which accounts for around 40% of the group revenues. I am in charge for Asia for Eurex, and that includes the overall distribution and customer business. Currently we have around 40 Exchange members and participants across Asia. Eurex has staff in Singapore, Hong Kong, Beijing, Tokyo, Taiwan, Mumbai, and also in Dubai.

I am also responsible for global cooperation for Eurex with partner exchanges. Like for example, we have a very successful cooperation with the Korea Exchange, another one with Taiwan Futures Exchange, TAIEX, and we also have a 5% stake in the Bombay Stock Exchange.

Having been with the group now for a bit more than 26 years, I kind of started my career at the very early days of electronic derivatives trading, from day one.

Qi Wang

MegaTrust Investments Group

My name is Qi Wang. I work for the MegaTrust Investments Group, a research-driven, boutique fund manager specializing in China A-shares (domestic Chinese stocks). The company was originally founded by Charlie Chen, one of the first QFII portfolio managers with over 23 years of experience in Chinese equities. We manage approximately US\$500 million today and have one of the best long-term track records in the industry.

We focus on a single strategy of long-only equity in China, and we have been doing this successfully for the past eight years, having weathered the storm in 2008 and generating an average alpha of 20% each year. We hold asset management licenses in both mainland China and Hong Kong. Officially I am the head of the Hong Kong office and in charge of the institutional business globally. My primary role is to capture the cross-border flow of capital, namely the inbound investment by global investors into China, and the **outbound investment by our existing Chinese clients to global markets**. The latter is probably one of the biggest trends in the last couple of years which we can talk more about it later.

Connie Lee

WTS

This is Connie Lee from WTS. The headquarter of WTS is located in Germany. We are a large international network and have presence in over 100 countries around the world. In China, we have offices in Shanghai, Beijing and Hong Kong. I am based in Hong Kong, but I work closely with China offices and other offices in Asia as well as in Europe.

In general, WTS China provides tax consulting and business consulting services, except for audit. WTS China does not provide legal services but in many other parts of the world, we do have legal practices. Many of our professionals are from Big Four accounting firms or renowned multi-national companies. Before joining WTS, I worked in Ernst & Young Hong Kong for over 12 years specializing in taxation.

WTS China was set up in China for about 10 years ago. We are serving a wide range of customers, including financial industries as well as retail, manufacturing, information technology companies, banking, insurance and venture capital. We served venture capitalists, such as HSBC, Carlyle Group, JP Morgan. We assist our clients to solve their tax issues, negotiate for preferential tax treatment, tax refund or set up cash pooling, etc.

My fellow colleague, Mr Steffen Gnutzmann, who is from Germany will talk more about our German headquarter.

Andy Mantel
Pacific Sun Advisors

My name is Andy Mantel, Founder of Pacific Sun Advisors, a company I set up around 15 years ago. We manage money in Chinese equities, and also do investment advisory services. This past August we won a mandate to invest some of the assets for one of China's largest financial institutions, and last month they increased their allocation with us. We are now at the early stages working on similar investment mandates. In addition, we also manage a special situations China equities fund, which is open monthly for qualified professional investors globally, with both non-US and US feeder funds. Lastly, Pacific Sun Advisors is working with some global investors on some cross-border investment opportunities, that include both fund raising and investing from/in China and elsewhere.

I have been living in Asia for more than 25 years. After working at Lehman Brothers in San Francisco, I moved to Taiwan in 1990 and the next year, after a huge stock market collapse there, I helped open one of the first QFII accounts with a major local brokerage firm. In 1992 I joined Taiwan's largest fund manager and helped them develop their business in China, moving to Hong Kong in 1992. That year, we set up the first fund management company in China, it was a Taiwan-Shanghai joint venture and a pilot program, years ahead of the set-up of China's first formal fund management industry. At that time, I was based in Hong Kong but also spent approximately three months a year in Shanghai as representative for our Shanghai office between 1992 and 1998.

I managed the firm's China listed securities portfolio and achieved a very good track record with this joint venture fund management company. I then decided to set up Pacific Sun Advisors.

Early investors in funds that I have managed include *the Shanghai government, the Ruentex group of Taiwan, Temasek, Jayhawk Capital, units of both IKEA and LEGO, and Marc Faber*. Looking forward, in addition to our China special situations fund, we expect to get additional managed account mandates from various major Chinese financial institutions and high net worth investors.

We are based in Hong Kong and also have an affiliate office in Nanjing. Pacific Sun Advisors other major shareholder is Liu Xuezhong, who is one China's most famous and successful early stage investors.

Steffen Gnutzmann
WTS

My name is Steffen Gnutzmann, also of WTS; however, while Ms. Lee comes from Hong Kong, I am from Germany.

WTS is a 650 people strong advisory company in Germany, specializing in tax and consulting and legal advice. We do not offer financial statement audit services, because there is often a conflict of interest between tax law and audit work. So, we have 650 advisors in Germany which puts us among the top 10 in Germany, and we also have a global network of advisory specialists, as Ms. Lee already described.

WTS advise numerous German industry clients, among them many DAX 30 companies, in all types of tax law matters and general consulting topics.

WTS also has a specific Financial Services department, which is probably our most globalized team. There, we service mutual funds, hedge funds, private equity funds and their institutional or private investors as well as banks, investment banks, insurance companies in many different aspects. We have German and many non-German clients. As an example: in Germany many of the large DAX companies invest pension fund assets into a mutual or hedge funds, German and non-German funds. We service our international clients via our global financial services industry group spread over many different countries.

Personally, I am a lawyer. I have a diploma in tax law from a German tax administration internal university; then I studied law in Berlin. 26 years ago, I was in China for the first time, traveling for four months in the winter of 1989/90. It was a completely different world then.

Ming Pan
Guotai Junan Allianz

I am Ming Pan from Guotai Junan Allianz. We are a mutual fund company here in Shanghai, one of the first joint venture mutual fund company established in Mainland China. Our AUM today is about 40 billion renminbi.

I personally am a technology specialist, so I only invest in Asia listed companies in the technology sector. I currently run three funds, all invested in the tech sector, with slightly different flavors. I am originally from Shanghai, although I was in the US for almost two decades. I came back here maybe seven years ago. Prior to that, I was with a fund of hedge fund in Chicago.

Michael Hsieh
Deutsche Börse

I am Michael Hsieh. I am the Chief Representative of the Deutsche Börse Beijing office. I have been in the Beijing office since early 2016. The main responsibility of the Beijing office is to maintain the relationship with the Chinese regulators, exchanges, and associations of the financial and asset management industry in China.

We have two major cooperation projects with Chinese exchanges. One of them is CEINEX, an established joint venture with the Shanghai Stock Exchange and the China Financial Futures Exchange. The other one is with China Foreign Exchange Trade System.

We also provide the market knowledge on the capital market in China to the Group and also support other subsidiaries of the group in developing businesses in China, such as Clearstream, which has a very strong business in China, and also for the market data department as well as 360T, a OTC FX platform in our Group.

The other thing we do is a sort of soft support for the business, for example by providing training and education in China. Together with a partner, for example the China Futures Association, we provide professional training in China, even for the regulators.

Before I joined the Beijing office of Deutsche Boerse, I worked for Eurex, also as a member of Roland's team, since 2009. My main responsibility there was on business development in Greater China. Prior to Eurex, I worked in the Futures Industry in Taiwan for over 20 years.

Barry Lau
Adamas Asset Management

My name is Barry Lau. I am one of the Co-founders of Adamas Asset Management Hong Kong Limited. Adamas is a specialist in growth financing opportunities. We are headquartered in Hong Kong and have been in business since 2009.

I focus on our credit business, as a credit manager, we are predominantly focused on lending to growing enterprises, providing capital for expansion domestically in China or for overseas acquisitions when they are not able to obtain financings elsewhere. We do run a hedge fund style special situations fund, as well as a more private equity style close-ended fund.

Currently we are managing just north of US \$600 million across the firm. We are in the process of closing a new fund, our third fund, in collaboration with Ping An here in China. We are looking to execute exactly the same strategy, but with the assistance of our joint venture partner Ping An to grow this business further.

To address the needs and requirements of certain investors, we also have a company listed in London and Frankfurt Stock Exchanges to help investors who are otherwise unable to access our traditional funds but are able to invest via those listed vehicles. We do have a team in Europe as well in addition to Hong Kong.

70

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When we had our last China Roundtable in the fall of 2015, we were just over the financial market crisis that happened in China that spring. How has China done over the last 12 months, what can you share in terms of an update?

Ming Pan: As a technology specialist in general I don't pay too much attention to the macro or the overall market, but I think just specific to the tech sector, I can say that 2016 has been a tough year for this sector. 2015 was actually a great year, my fund was up like 95%. But this year it has been much more difficult.

But I think this is just a small setback. I am pretty optimistic for 2017, because the fundamentals of the tech sectors are still pretty good. The valuation level may still be high, but it has come down from much higher levels 12 months ago.



Barry Lau: In our view, China is transitioning away from what it used to do over the last 20 or 30 years, which was the manufacturing hub of the world. People are forgetting that China has already moved on.

And as Ming has mentioned, tech is a major theme, and also services, consumption represent major growth sectors. Therefore, *a manufacturing slowdown doesn't necessarily equate to an overall decline*. A lot of commentators have mentioned a hard landing in China. I agree that we have seen slowdown, but it's probably for the better because there is more quality growth. We are still registering north of 6% of growth in GDP, which is enviable by global standards at this juncture in the cycle, in our opinion.

We do believe that the transition towards a really diversified economy will take a few years to play out properly, and therefore there will be **volatility**. The ride will be bumpy, and as such, I guess stock picking is important if you are focused on the equity market. For the credit market, obviously you need to ensure to ascertain sustainable cash flows through the earnings from the specific companies that you finance.

Moving forward, people would have heard about the “**One Belt, One Road**” initiative orchestrated by the government, amongst other things. I think this will be a great contribution to get the economy back on a growth path. There will be infrastructure plays but also a lot more, I would say, outbound investments. There are many ways to assess this, but specifically, I think the primary driver would be to establish the **RMB** as a more recognized currency to the neighboring countries. With Trump into power, this could be controversial; but I think he will be very busy dealing with domestic issues and thereby allowing China to really grow its presence and its significance in and around the region here. And therefore, the *RMB may well become more freely traded on a much sooner scale than it had previously anticipated*.

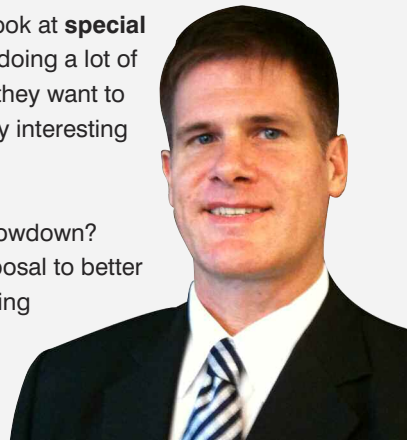
So, I think it's all positive for China, but it will be a bumpy ride for a few months, may even be years, but there will be ample opportunities to make money.



Andy Mantel: From my perspective, having invested in Chinese equity since the start of China's markets over 20 years ago, my view is that the *current market represents by no means a stress point as we had in the previous business cycles*, like during SARS and other times when the markets collapsed. But I think *overall valuations for Chinese equities are very good and can represent attractive entry levels for long-term investors*.

However, we are not focusing on blue chips at this time or a standard portfolio. Rather, we look at **special situations** using a private equity style approach, which I think has a lot of potential. We are doing a lot of research figuring out what companies are doing right now, who they are working with, how they want to sell their business to someone in China, how to get a shell company, etc. I think this is a very interesting way to look at the China market when working so closely with companies.

Overall, I don't see a lot of risks. China still has a very good growth rate, so is it really in a slowdown? When you look at the burgeoning middle class, the amount of money they have at their disposal to better lifestyles, whether it's sports related, healthy lifestyles, etc., we are very excited about investing companies from these sectors.



Qi Wang: When the Chinese stock bubble burst in 2015, instantly a buzzword called the “**Famine of Assets**” was coined, referring to the phenomenon of too much money chasing only a few “good” assets. Immediately after the stock market crash last year, China ran into a bond market bubble, an on-going real estate bubble and arguably a private equity bubble... Why? There is simply *too much liquidity*.

Whether such lemming-like behavior is rational or not is subject to debate. However what this truly reflects is the *lack of quality investable assets for Chinese investors, individuals and institutions alike*.

The problem is not just about quality but also the scale. People tend to think about China as an over-leveraged country, but we are actually an **over-saving nation** as well. *The total savings deposits are estimated at around US\$25 trillion, and savings rates are normally 50% of the GDP*. Just like Barry said, the Chinese economy is slowing down but still growing, so in absolute terms, the savings continue to grow significantly year after year.

In contrast, the domestic bond market is “only” around US\$7 trillion, most of which is inaccessible by individuals. The domestic equity market is also around US\$7 trillion, but something like 65% is owned by the government locked away. The investable free float is only 35% or just shy of US\$2.5 trillion.

The bond market may be too small. The equity market may be too “risky”. Real estate investment is off limits due to the numerous restrictions in place to cool off the market. Capital control is getting tighter by day and thus no money can leave the country easily. Meanwhile the rates are coming down and the currency is depreciating... Whether you are a wealthy individual, a large corporation or an financial institution in China, all are facing the same problem, where do you put your money?



Steffen Gnutzman

I wonder, why is there a lack of quality investment assets?

Qi Wang: Well, bear in mind that in absolute terms, there are still a lot of interesting opportunities in China. It's a big country and has many regional or structural imbalances that will continue to offer investment opportunities. But there's simply too much money on the sideline. Too much money chasing too few good ideas. Ming covers the TMT sector, so he probably knows what I am talking about. For example, if you do **venture capital** in China, your *biggest competitors are not just other VC firms, but BAT, which are Baidu, Alibaba and Tencent*, and plus countless entrepreneurs and traditional business people who want to get into this field. Yes, there is a lot of innovation happening in China, but it can't catch up with the growth in the so-called "excess capital".

Simply speaking we need more ideas, channels, or ways to invest the wealth that has been accumulated in the last 30 years.

Secondly, as you know, the rates have continued to come down in China, at least not going up. China has been cutting rates since 2012. The monetary easing also creates a lot of the problems in terms of whether people can generate decent returns on their money.

Currency is the third dimension. A while back some people predicted the RMB is going down to 6.8 (vs. the dollar); we are already at 6.8. Now people talk about 7.3 next year. The expectation for further depreciation is prevalent in the domestic market at least.

This is something new, something special in this economic cycle. This is likely the first time in the last few decades that *China faces both economic slowdown and currency depreciation at the same time*. We think this will last for a while, not a short-term thing. We won't be surprised to see a double-digit depreciation of RMB against the USD in the next three or five years. It would be gradual but has significant implications to making investments over the long-term.

We also have an aging population in China. It is estimated that by 2020, the percentage of 65+ years-old population will surpass that in Japan. China will be the most aged country in the world. This is the reason why China recently abandoned the one-child policy and now allow families to have more children to help address the aging population issue. But what this also means is that there will be even more retirement savings and more demand for good investments generate decent returns for people.

Lastly, we already mentioned that both Chinese individuals and institutions have increasingly realized the importance of diversification, and **global diversification** I mean here. If you went to a Chinese company ten years ago and said you wanted to help them invest abroad, you would have probably been kicked out of their office. They would probably call you crazy and say "I have so much growth here in China. Business booming is here why do I have to go abroad?" But now? I don't think the same pitch will get much push-back, if any.

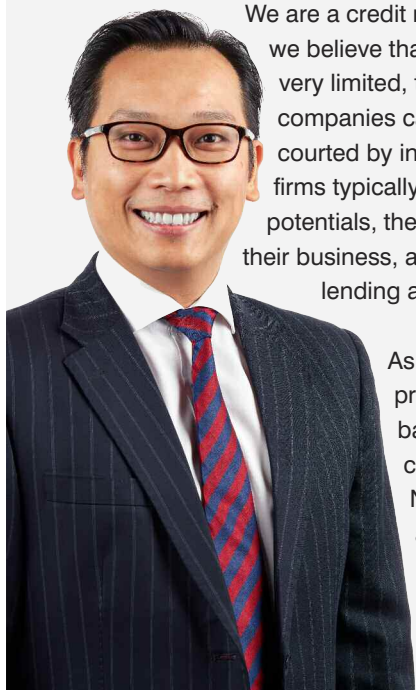
Our company just launched a Hong Kong Connect product, an actively managed fund allowing certain Chinese investors to access the Hong Kong stock market. One of the biggest selling points here is the currency, because investors can expect to pick up 2% annually just on currency alone. On top of that they also get the equity return (beta) and the alpha that we generate.



Barry Lau: Steffen's question is relevant, people have in fact been talking about the investable asset classes, especially when I do fundraising in the West. Many people also ask about distressed opportunities in China, NPL opportunities.

Qi mentioned the bubble in Chinese private equity. It is commonly known that **PE in China**, which comprises anything from angel investing, all the way to huge buyouts, has amassed a lot of money.

When one asks overseas allocators in relation to details on their Asian investments, you'll find that the majority of their allocations would typically be Chinese private equity growth investments. So you can see that the growth story has been bought in by a lot of investors, but I think it is questionable if these same funds have been able to successfully allocate to growing companies. *There are 50 million private companies in China, and I would say many do grow with CAGR of 30% plus. The question is if you are able to identify them?*



We are a credit manager, and so we have been looking at both the demand and supply side of things, and we believe that the better way to play China is on the **private credit** side because bank financing is still very limited, that channel is mostly available to the larger corporates. Only about 5% of private companies can realistically get any meaningful form of bank financing. The other 95% have been courted by inter alia, shadow bankers and private equity firms in some form or another, but private equity firms typically would like to have a large stake in the corporate. If it is a company with strong growth potentials, then surely the entrepreneur would probably prefer to be less diluted, if they really believe in their business, and therefore prefer a pure credit based financing. From that perspective, we see private lending as more suited to them.

As to the **non-performing loans** or NPLs, people typically associate China with a huge NPL problem and therefore they worry about the economy as a whole because by extension banks are going to have issues. But being on the ground here, what we do see is a lot of credit opportunities but not that much NPLs, we don't believe there are that many meaningful NPLs available. Banks have been lending mostly to SOEs, state-owned enterprises. SOEs are essentially government-owned, so yes, there would be issues because of the abundance of liquidity supporting them. There will be changes, there will be privatization and consolidation. But at the end of the day, the government is there to bail them out.

Andy Mantel

Question on your private lending business, what type of banks are you working with and do you have some type of a put option or protection on the private companies you work with?

Barry Lau: Well, the Holy Grail of proper lending in China is that you need to have access to onshore RMB. If you have onshore RMB, then you can do a few more things.

We entered into Entrusted Loans with local banks to offer financing on a tripartite basis to local companies. Therefore, we have actual charges registered onshore in China which means that we also have been able to enforce successfully against the few who tried to run away. *We have been to courts in China four times and we have won every time so far.* Well, fingers crossed, but litigation is never easy and it's never favorable. But what I want to articulate here is that **China's legal system** has moved on compared to 15 years ago. It's a very old story to say Chinese courts do not have respect for the rule of law. I think it has really improved tremendously, especially in cities like Shanghai. The commercial courts here are really eager to be on a par, on a level playing field, with the outside world. There would still be plenty of room for improvements, but certainly I think commercially, they are much more ready to appreciate and also to learn about how the overseas legal system operates.

Now, China can issue 100 regulations, new regulations a day, so we will have to wait and see, but I think all the steps that have been taken have been positive and will contribute to a better system from a lending or investing perspective in general.



Barry Lau: There's a lot of money available for private lending. Going back to Qi's point, there is still a lot of money on the sideline and we are just one of the areas or a new asset class, if you will. And when you look at it, private lending, even on a global basis, is still a very small asset class.

There is about US \$560 billion allocated in this asset class currently to date. About 90% of that is allocated to the US and Europe. Mostly it's the US, and China is still very limited in terms of the share of the pie. So in our opinion, that has to grow.

Sometimes when talking about this asset class in China, people have associated with the term "shadow banking industry", which I think has some sinister connotation to it, but actually it's not so sinister. The sector comprises pawn loans, microfinancing, financial leasing, trust, and all these are all highly regulated. Institutions like the CBRC, CSRC, MOFCOM are all over the place and are watching the backs of this industry.

But yes, there is also a lot of informal lending. Someone with lots of surplus cash could lend on an informal basis. That's an area that I think the government is trying to contain, and I think it's correct that they should.



Going back to Matthias' question if we think there's crowding, you also have to put that into perspective in relation to China's size. Because it's such a big country, depending on whose research you read, the size of **funding gap** according to our in-house research is about US \$1 trillion, but some other research houses have come out with US \$5 trillion to US \$7 trillion, which I think it is a bit of a stretch.

Our sweet spot is US \$30-50 million per ticket, which means we are going for mid-market, not really the mass market. I do think that there is a lot of mass market informal lending going on, so we would view that sector as crowded, and there will be a lot of problems going on there.

If we go a bit higher up in the food chain, so \$50m, \$100m and more, that's where private equity sits very comfortably. We also see that space as a bit crowded and therefore returns may suffer, unless you could do what Andy has said earlier, some special situations opportunities, which we see is a great opportunity as well, things like cross-border, special situations, acquisition of shells, asset injection, etc. But again, in the midst of that market we believe that there's a much less crowded area, because very few people understand that space as well.

Qi Wang

Just a question for Barry. When you talk about the special situation fund product, is it in US dollar unhedged or do you have to hedge the Chinese currency? Do you worry about the currency risk?

Barry Lau: That's a very difficult question to answer. I think the **currency risk** is a real risk. It's scary because as a credit manager you are only making say 12%-15% on a net yield basis, the currency can really erode all your gains if you are not careful. So yes, we need to address the currency risk.

We are an US dollar investor, which means that at the end of the day we need to hedge back into US dollar. There are two ways to mitigate that. One is you can do a rolling NDF, so you just do forwards, but it's still going to cost you a couple of percentage points.

Historically, when the RMB volatility was less, we could buy cheaper hedges, for example a three-year option with a call on US dollar and put on a CNY. Those would have been much more favorable, but right now they are still available, but not at the price that we want to pay.

Last, but not least, the typical structure we use is we'll gross up the cost of currency conversion. We want our return to be 12-15% net in US dollar terms, so we pass the risk back on to the borrower. And you may ask why would the borrower want to do that, because then essentially they are coughing up a lot more. That's because we are differentiated compared to a lot of overseas lenders in that *our loans can be capitalized on the balance sheet of the borrowers*.

This may sound a little more technical, if a US dollar investor has a holding company and then financing an onshore company, that onshore company will still be considered as an offshore company, and therefore, you can do a shareholder's loan, but that shareholder's loan cannot be capitalized. However in our model, our loans can be capitalized because we do Entrusted Loans, which is onshore RMB, co-lending on a tripartite basis, utilizing local banks as our agent. This means that the borrower can treat that as a cost and therefore it's more favorable. Therefore we tell them they will have to gross up the return to us then accordingly.



Connie Lee: Regarding an outlook on China, I am personally quite optimistic about the development of the Chinese market. In 2014 we have seen the launch of the Shanghai-Hong Kong Stock Connect, and it runs quite steadily. The Shenzhen-Hong Kong Stock Connect has launched in early December 2016, allowing overseas investors to trade 881 stocks and thus offering investors more exposure to China's tech sector than the Shanghai Stock Exchange.

So this definitely offers more opportunities for the overseas to invest in China. While the Shanghai market is more concentrated on the state-owned enterprise, Shenzhen is more for the newly established high technology companies. These companies now have the option to raise their funds in the Hong Kong markets while at the same time international investors can invest into China. This strongly demonstrates China's commitment to liberalize its financial markets and to further open up its capital markets to the world.



Roland Schwinn: Looking at it from an international market infrastructure provider's perspective, China is still a rather restricted market when it comes to trading international markets outbound of China and also the other way around.

Of course, as a global market provider, we have a strong interest to tap into China as a liquidity pool. For many years we have been very active in engaging with Chinese financial institutions, starting from banks, brokerage firms, FCMs, but also into the buy side.

At the beginning, our activities were more or less concentrated on trying to get IPOs for our Frankfurt Stock Exchange market, but now we also focus a bit more on the buy side. So we work together with the FCMs (Futures Commission Merchants) in China represented by the China Futures Association (CFA) where we have cooperation in place now for five years.

Michael mentioned already earlier that we are very active with the CFA, also providing trainings about derivative products, clearing mechanisms, risk management, and also, as I mentioned, getting more active at the buy side. However, while we still face restrictions, there have been positive developments.



Around seven or eight years ago China allowed Hong Kong-based FCMs to trade international derivatives markets out of Hong Kong with a special license. At the beginning this was restricted to five licenses and later that number was expanded. These firms are able to trade international markets without any restrictions.

Later, a few more grants followed in the commodity space. FCMs and commodities were also allowed to invest directly out of Mainland China. We are very proud that we have become a partner of a major Chinese stock and derivatives exchanges over these years. Last year, for example, we launched a joint venture together with the Shanghai Stock Exchange and China Financial Futures Exchange called CEINEX, **China Europe International Exchange**, which is based in Frankfurt, outside of China. This allows us, the joint venture partners, to be a bit more flexible when it comes to offering Chinese products.

The initial purpose of this joint venture was to launch RMB denominated products for the distribution outside China, targeting European, US and also to other Asian investors.

The joint venture has just been launched in November 2015 and it's picking up gradually. We have started listing ETFs and now are also launching the first derivatives on those ETFs, but generally it has a very strong equity focus.

In this China Europe International Exchange, the Shanghai Stock Exchange has 40% stake, and CFFEX, the China Financial Futures Exchange, has 20% stake, and Deutsche Börse Group has another 40% stake. The next cooperation we are currently preparing will be more about the fixed income and foreign exchange asset classes. This is a cooperation with CFETS, the China Foreign Exchange Trade System, which we are currently setting up. The idea is also to start a joint venture outside of China to *list RMB denominated fixed income and FX products* in the long run. So, as you can see, it is important for us to have solid partnerships in China, with Chinese partners, in order to not only explore the outbound potential in terms of the flows coming from China to our markets, but also the inbound potential of flows coming from our markets into China.

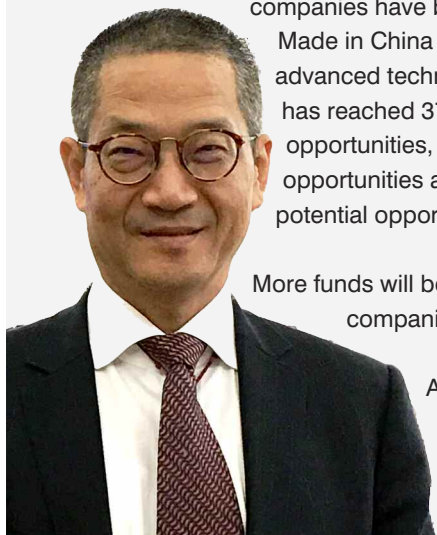
Michael Hsieh: I just want to share some observations about the general trends that I see. I think we are in a transition period where on one side, regulations will become stricter and more conservative, and economically the government is trying to stabilize the GDP growth to around 6-7%.

If you look at the international landscape, the new US President Trump will also influence the Chinese policy – we will find out soon.

Barry already spoke about a major Chinese national policy, the Renminbi internationalization. The next policy to focus on is the “One Belt, One Road” initiative, and the third one would be the **“Made in China 2025 strategy”**. All these policies are closely linked to Germany. We have already shared how Deutsche Börse reacted to the RMB internationalization. The “One Belt, One Road” project ends in Rotterdam and passes through Germany. And if you look at 2015, around 26 German companies have been acquired by Chinese companies – the trends relate to the cooperation between the Made in China 2025 and German Industrial 4.0. As we know, Germany is very good in manufacturing advanced technology products and services. In the first half of 2016, this number of acquired companies has reached 37. Currently, we see the trend that more and more funds are going outside to find opportunities, while China focuses on stabilizing its domestic market. The previous investment opportunities and growth, compared to the past several years, is decreasing. To discover the new potential opportunities, we shall follow the three national policies.

More funds will be invested overseas, especially Europe, where China may cooperate with European companies to promote product, service and technology into the Chinese market.

Another new model - the concept of the high speed train model. China built high speed train system with the technology from Japan, France, and from Germany. Now the high speed train covers the One Belt, One Road countries.



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This is a new business model that I have observed. It means that a lot of the SOEs (state-owned enterprises) or even the private sector company will look for cooperation on advanced product, service and technology outside of China. We do see some risks, but also potential opportunities with the “One Belt, One Road” policy.

Barry Lau: We also see a lot of interest and activity in outbound investments out of China. This is not without limitations, because China is still trying to restrict the RMB flowing out as well as flowing in.

There is an economic driver in bringing established technology to China's enormous mass market. For example, we have been looking at a transaction in Sweden – a Swedish technology that has been applied to 5 million people or users in Sweden. Sure, they could expand to places like Denmark or Finland, but also these are smallish populations. Now imagine bringing that technology to China or even just to Shanghai alone which has a 20 million population.

So while manufacturing is in transition, you can still improve the efficiency of manufacturing by applying better technology, better expertise, which is also a very good opportunity for China as a whole. So from that perspective China's future is not only in services, consumption, technology – we are moving towards those – but there's a J curve in everything, and this J curve could be mitigated by technological advancement in manufacturing. And those are going to be sought from Europe, because Europeans just started a lot earlier on a few fronts, and there's no point in reinventing the wheel by Chinese companies if they can either JV with them. However, currently my understanding is very few want to JV, they just want to **buy out**. This is certainly the trend.

We are also seeing a lot of push back by Europeans saying I don't want to sell to Chinese firms. We have seen that as well, and that's an issue we need to address. We've also seen that when a Chinese buyer is expressing interest in a company or an asset, then the price suddenly goes up by 20%, 30%. That's also something we have seen.



Matthias Knab

Qi, you did write some very interesting comments on how to do fundamental research in China and how maybe the traditional Western metrics don't work here. Can you explain the background of this phenomenon to us, and how you do your research? What else should be applied when looking at Chinese stocks and opportunities?

Qi Wang: A lot of Chinese fund managers claim to have deep fundamental research, but how much research they actually do is a different question. It's common, and perhaps understandable that many managers here would “shoot first and ask later” because China is such a retail-driven and impatient market. This means that *some institution investors also trade like retail*. If you look at the average turnover of publicly-raised mutual funds, it could be easily 7-10 times a year. In some cases, the broker commission and the management fee together outweigh the net profits of the fund.

At Megatrust, we have relatively low turnover and very high conviction in the few stocks we own. Fundamental research is at the core of our investment process which is similar to the global institutional standard. The difference is in that we need to localize the process to the Chinese market.

One of the main challenges of doing fundamental research in China is the scope. It can be so broad. There are really no limits to how much you need to know about the company in order to make an informed investment decision. This means that there is just *so much more work in addition to the traditional Western framework of analysis*, such as financial statement analysis, the ROE breakdown and the whole nine yards. That's basically the minimal you have to do. On top of that, you really have to spend a lot of time with the company management, the majority shareholders, the industry supply chain and etc. to know what's going on. There is always more than meets the eye.

Now, as we were discussing today, the most important factor investing in China is corporate governance. This is evaluating governance in a Chinese context.

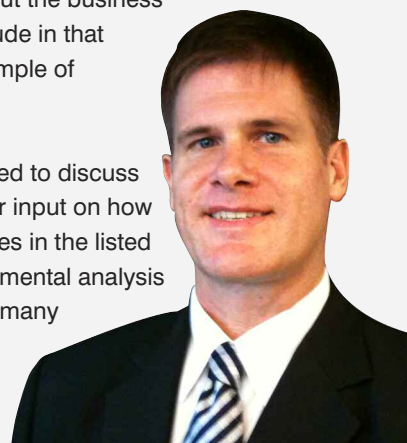
At MegaTrust, we have developed over the years our own proprietary **governance analytics** where we use unique metrics to determine whether the target is a well-run company. For example, one aspect we often look at is the risk management capability of the company. This is about who is on the management team and what is their track record in managing down cycles and extreme events? What have they done previously to mitigate the business risk? What have they promised investors in the past and how well they have delivered? Let's say they have just made an acquisition overseas, can they successfully integrate this into their organization, and how well can they have manage the risk of this transaction?

These are just some of the things we pay our attention to. The challenge is also that China is such a dynamic market. There are major events every day. *Despite being in a bear market, there are still around 200 IPOs in a year*, so nearly one IPO per trading day. There are hundreds and thousands of restructurings, re-organizations and M&A announced every year. Many of the deals are cross-border as in the trend we mentioned. Companies change their names frequently and they always try to diversify, acquire or find something new to do. As investors, we have to be very careful with what we get into and need to fully understand these transactions, all of which are within the "scope" of fundamental research.



Andy Mantel: I fully agree, we also place a lot of attention to the management and their economic interests in the listed company. Sometimes we find that they have the listed company which has certain assets, but the business group also have other businesses that are not part of their listed entity, which they may include in that listed company later on or they may have plans to list that elsewhere too, and this is an example of information you can only get when you meet with the founder and Chairman.

A few days ago, while on a company site visit in Tianjin, the Chairman of the company wanted to discuss his other parts of his business group that were not in the listed company, and he wanted our input on how they could monetize these other businesses over time, by possibly injecting these businesses in the listed company. This is also one very specific aspect that you cannot get from just a normal fundamental analysis when you're just looking at the numbers. My partner Liu Xuezhong has successfully helped many Chinese entrepreneurs access growth capital for their businesses.



Ming Pan: We spoke about the overseas investments of Chinese corporations, which is also a major theme in the TMT sector. A lot of the tech companies in China are making overseas acquisitions, for example the lens module business of Sony has just been sold to a company in China. So even great Japanese companies are being acquired by Chinese companies.

The way we see fundamental research of course includes doing a lot of on-site business due diligence and meetings with management. We also go outside of China, for example to Taiwan where there are a number of supply chains and companies relevant for the electronics industry. We like to do fundamental research so deep that whenever there are certain events or something negative to the company, to the sector, or to the overall market, that we know how to react properly.

Because sometimes the market may overreact and that's when often our knowledge and our research can benefit us because we know how to react properly.

Let me try to be more specific. The TMT sector in China has four sectors. The first one is electronics, then there is media, and the third one is telecom equipment/services, and the fourth one is computer hardware/software. This year, electronics has been the best performing sector followed by telecom, and computer and media are the worst performing sectors within TMT. Actually they are the two worst performing sectors overall in the Asian market. However, I believe probably in 2017 things are going to change a little bit. I think just by the way some of the fundamentals are changing and just by some kind of mini reversion, I think the media and computer sectors are going to be performing better than this year.



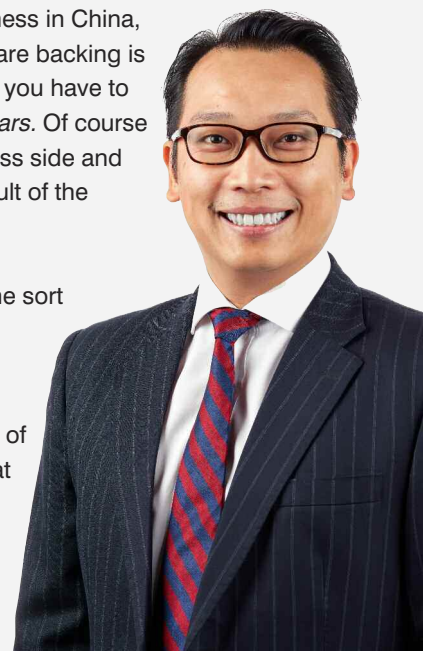
Barry Lau: When we speak about China, obviously everybody knows it's a very big country and that there are a lot of people, but the country is also very fragmented. Most people know about Beijing, Shanghai, they probably know Shenzhen, maybe Guangdong. However, there are 31 provinces and if you go to the western side of China, it's very different from the eastern seaboard. The middle areas also have very different characteristics. Each province could almost be characterized as a different country, if you will, but obviously all of them are very well assimilated into the central system.

That being said, I concur that evaluation is difficult because you can't really look at China using the periscope of the Western market, although when you look at the P/Es of the US market on a relative basis, it's 20-odd times P/E, so the domestic China market doesn't seem so frightfully expensive.

I agree with all what we discussed regarding risk parameters. When you invest or do business in China, whether it's a listed company or otherwise, understanding the behavior of the person you are backing is very important. You are not backing a company, but you are backing an entrepreneur, and you have to understand *our so-called capitalistic attitude has really only developed in the last 30-40 years*. Of course China has those 5,000 years of history, but that is the culture. When it comes to the business side and the capitalist markets, actual new businesses we are seeing right now are really only a result of the recent developments that happened over the last few decades.

The old hands in the industry, like us here at the table, understand the issue of having some sort of **risk metrics based on governance**. In our case, our governance also checks on the service providers. These service providers appointed by the entrepreneur also help us to assess the credibility of the overall values and numbers we obtain from the company. We also check with the tax bureau on the tax filings. We want to be certain that the declaration of any spending can be measured up or corroborated tax filing that the company makes. That will give us a better assessment and at least mitigates any potential fraud risk we are concerned with.

Another thing we are naturally concerned about is **conflict of interests**.



Andy mentioned this already, are certain assets on or off balance sheet? Is it going to be a connected transaction? And how that will be addressed? It may make a lot of money for the shareholders, but is it necessarily good for the company as a whole? So we tend to be more cautious here. Because we are a debt investor, we don't really care about whether the company makes three times or more returns, my focus is, in making sure that we get our money back and we get paid on time. Conflict of interests is a very key issue for us to consider.

And then on top of that and finally, we can't limit our analysis just at the core, traditional business activity of a company. For example, we also have to think to a degree about things like *environmental protection*, because at some point in the future the government may well say, "Well, you've dug up a hole there, so now you got that liability attached to you for the next 10 or 20 years." You just want to make sure that you avoid latent issues that you could think about already today. In such a case, you may nonetheless still decide to invest so long as the company has given you a plan and a decision tree that can help you to understand that they thought about it and they know how to resolve it. So those are some of the soft or secondary metrics we apply.

Andy Mantel: One other risk that international investors should keep in mind is not to expect any sudden opening of the markets. It is positive that there are more ways to invest in China but still, foreign investors have limited choices. Being involved in the Taiwan QFII back in 1991, investors were given a choice to work with many different brokers and buy many stocks, and they can get their money back in a shortened period. The capital markets deregulated very quickly there. *China however has gone from a snail's pace to a fast snail's pace to opening up the markets.* So for investors, this will be something to look for on how to invest in markets and companies and which ways they can.

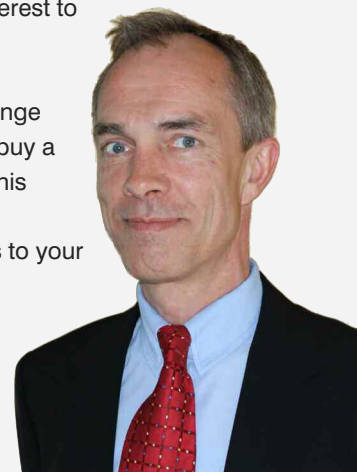


But China can definitely open up the markets much more faster, make QFII more interesting, RQFII and also the stock connects, these are positive, but in my view, from my experience, they can still move much faster to allow foreigners to invest in Chinese stocks.

Steffen Gnutzmann: Do you see interest from European investors going directly into Chinese domestic fund entities? With your knowledge of the local fund industry, does it seem that this investment route could be of interest to non-Chinese investors?

In this context, it may be interesting to know that especially **German investors** will see a big change coming on the 1st of January 2018. Right now, German investors will find it extremely difficult to buy a Chinese onshore fund because of German tax law problems. But from the 1st of January 2018, this landscape will change completely and tax law as a hurdle or as a soft market entry barrier to the German investor market will disappear. For you and those interest in attracting German investors to your funds, this change brings the possibility to market to German investors easily.

And so, back to my question, do you observe interest by European or German money to go directly into Chinese local funds?





Steffen Gnutzmann: At the moment, if a German investor, irrespective of whether it is a private or a German corporate investor, invests into a non-German fund, then a specific set of German tax compliance rules must be observed by the fund. Specialized advisors like WTS help to extract the German tax law relevant figures out of a Cayman, Hong Kong, Singapore or - maybe - a Shanghai based fund. But from the 1 January 2018, this will basically not be an issue any longer.

Therefore, if you have German contacts which maybe were reluctant to go this route in the past, from the first of January 2018, it will be much easier for you to accept German investors, at least tax law-wise. Of course, there are distribution rules that will have to be observed. But tax law-wise, it will be a complete restart and much easier than in the past to onboard German money into your vehicle, whether it's a Cayman fund or a Shanghai fund or a Hong Kong fund.

Qi Wang: At the moment, accessing onshore Chinese funds from overseas is not straightforward, it's tricky. But apart from that, I also believe a lot of the global investors today are waiting for clues on A-share index inclusion before making a move. For those who may not be familiar with this topic, at the moment, there is about US\$3.2 trillion of assets tracking the global emerging market indices. These indices are offered by companies like MSCI, FTSE Russell and S&P etc.

Of this emerging market pie today, about 26% is China, but these are not the mainland China listings but Chinese stocks traded in Hong Kong and the U.S. For example, Tencent, China Mobile and Alibaba. Today **China A-shares** are still not part of this \$3.2 trillion pie. Zero. Nil. Bear in mind that this is already the second largest stock market globally.

Now what will happen if these shares are fully included into emerging markets? On top of the current 26%, that will add another 24% of A-shares from China, *so one day China as a whole would be easily 50% of emerging markets*. Again, roughly half of that is offshore China and the other half is China A-shares.

China A-share going from 0% to 24% of emerging markets means a lot of new money will have to come into this market, if this index inclusion happens. This will be a major trigger or factor regarding your question of if, when and how people will invest in Chinese equities. We estimate there will be *US\$640 billion of inflow to the China A-share market over time*. Of course this is a chicken-and-egg question, depending on how quickly China opens its stock market to foreign investors. As Andy said, we are moving in the right direction. We are moving slowly but surely the market is being opened up, and the new Shenzhen-Hong Kong Stock Connect is part of this.

These are the positive signs and the next review date for MSCI is June 2017. This year, unfortunately they shut it down again, but hopefully next year there would be more positive news for all of us.

**Ming Pan**

Also at from our side ell, I don't think we have seen any direct allocations from European or German investors. We have seen in the past allocations from European insurance companies who had joint ventures with Chinese firms. But most of our institutional allocations have come from major local Chinese insurance companies.

Barry Lau: One factor is the availability of onshore RMB. If you want to invest in China and back a local manager, you need to have RMB, and that has historically been the barrier to entry in a way, because a German investor presumably will be holding Euros. If he goes through QFII, perhaps then he can get onshore into China, but whether QFII would enable you to then allocate to private funds here, that's a separate question.



The other issue is of course the qualitative assessments of fund managers. As we mentioned, the universe of the Chinese private fund space is huge and it's constantly growing, and so getting to know everybody is difficult, if not impossible. Those firms who made it onshore have already established an offshore presence, much like Qi has done. That certainly opens up opportunities for investors offshore to allocate to local Chinese managers.

I think **Hong Kong** presents a good bridge into China for that reason. You are also getting a good level of international best practice in Hong Kong and the protection of a well-established Securities & Futures Commission as regulator. You also have the benefit of common law as an investor or as a fund manager.

You can then leave it to the fund manager in Hong Kong to identify local partners in China, and he or she has to figure out how to get the money onshore and ensure that he gets the best local knowledge back to you in Europe.

Steffen Gnutzmann

Will not the Mainland Chinese financial industry see this as a disadvantage for them that the money has to go through Hong Kong? Why wouldn't they want those flows themselves, or is it too irrelevant from a Chinese perspective?

Barry Lau: I think you have already articulated the answer. Right now the flow from overseas is still moderate, and it will drip-feed, so over time it could become big. What Qi has mentioned about the \$640 billion, that's not a small sum if it were to flow into the domestic market. On the private side, I think it will be a fraction of that, but still a moderate sum. For sure, many things will change once the government has freely allowed RMB to float, which is going to happen, but no one has the crystal ball to tell you when. It's in a way much like the German tax issue which also has been around for decades. Now they are lifting that, which is certainly welcome, but even once it's lifted, it will still take some time from an implementation perspective to understand properly how that may affect fund global managers seeking capital from Germany.

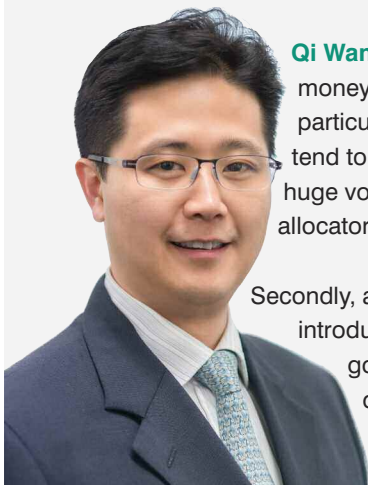
Therefore, the much bigger issue for the Chinese government to consider is whether and when the RMB is ready to float; and secondly if they actually want to bring in further new money into an economy that is already awash with capital on the sideline. So there are a few considerations that need to be contemplated.

This also affects my sector which is private credit, a \$560 billion global market with less than 10% allocated to China. That number will of course also grow, but the challenge remains how to get your money into RMB? That is still very much the barrier to entry at this juncture.



Steffen Gnutzmann

A lot of German institutional money is from insurance companies and - especially for insurance regulatory reasons - they like debt better than equity assets, or they must favor debt assets over equity. And therefore, a strategy like the one described by Barry should be quite interesting to many of them. I do understand that China probably doesn't need to search for investor money, but having a diversified investor base is an interesting aspect that could be taken into account.



Qi Wang: Correct, also from the regulator's standpoint they actually prefer long term institutional money. They made it very clear they want to open the market not just for more foreign ownership, but particularly institutional ownership rather than retail investors which punt the market everyday who tend to get into crowded trades, always buy and sell at the same time and because of that contribute to huge volatility in equity market. On the other side, insurance companies, pensions and the long term allocators are here not just for the short term profits but more to strategically make long term money.

Secondly, also there's an angle of hopefully improving the governance of Chinese companies by introducing more foreign investors. Like I mentioned earlier, I think China still has a very broad governance issue among all companies and we need to somehow meet the global standard one day. It will be positive for China, both at a macro and at a micro level, if that happens.

Barry Lau: I agree with Qi as well on the governance side of things. If we put aside the discussion about regulations, whether the RMB is really transferrable at the moment, and that China is market large enough, even apart from that it makes sense that for Chinese capital to look for opportunities elsewhere and for foreign capital to look for opportunities here in China. That's why Hong Kong as a bridge makes sense because it sort of bridges the gap between the two.

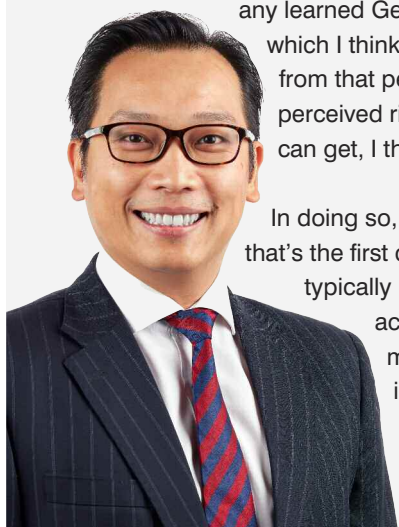
We will see direct flows happening eventually, but for the time being, I think having Hong Kong there in the middle is still good. Rather than just a capital exchange, I think we should also consider two things. One aspect is akin to bartering of technology; and two, a governance structure of the West in exchange for what China can offer via a yield enhancing program. Steffen mentioned insurance companies and pension funds in Germany, but the low interest rate environment is not just a problem for German insurers and pension funds. Their long term liabilities are a huge problem given the negative yield environment they have to act in right now.



Steffen Gnutzmann

I wonder...what is the situation of institutional investors in China then?

Barry Lau: It's all relative value. In China, at least one can get yield pickup. Currently, PBOC one-year lending rate is around 500 basis points. That in itself before anything spread on top is better than negative yield in the Euro zone. For the benefits of any learned German colleagues here at the roundtable, when you are running a defined benefit program which I think a lot of German corporates still do to an extent, I think there either needs to be an overhaul from that perspective, or you make a decision to take on a bit more risk or perceived risk. China risk is a perceived risk, because if you are able to get senior secured financing at whatever low double digits you can get, I think you have to do it. That's my opinion.



In doing so, you are swapping across three things; one is capital, Euro into China and RMB into Europe, that's the first cross. Second cross is what Qi has mentioned, which is instilling institutional money into a typically retail-oriented one, although the outbound would probably be driven by institutions but actually a lot of that money will be wealth managers' products which are repacking retail money. So while the Chinese market is heavily retail-oriented, by introducing some European investors will help institutionalize the market here. That is also welcome.

The third and final point is also allowing for some technology transfer or some sort of

bartering where we're allowing for transferring of some meaningful investment returns against the long-term liability deficits the Euro zone is suffering from. China is also obtaining from the West some degree of governance improvement and some technological advancement, either in the corporate domain or the management domain. So, I think all of that is welcome.

Matthias Knab

Can we go a bit deeper into the clean up you have seen happening in the Chinese onshore funds industry? We know that at some point there were 30,000 so-called sunshine funds, and now there are 7,000. Can you give us more details on that process and where you see China in a few years from now?

Qi Wang: Our firm actually belongs to those 30,000 so-called private fund managers, also known as **sunshine funds**. So in early 2014, we were in the first batch of sunshine fund managers to get registered with AMAC (Asset Management Association of China). Of course a lot has happened since then, the stock market bubble burst, numerous small managers and peer-to-peer financiers went down, people got arrested and despite the crackdown there are probably still some "bad apples" out there.

But this is perhaps not surprising. Like any industry at its early stage, you always get a lot of good and bad apples mixed together. I think regulators are now trying to clamp down further and reduce the number of sunshine fund managers to a controllable range. They are also introducing new competition. As you may know, there is now a new rule allowing wholly-owned foreign managers to get licensed by AMAC. It's called the WOFE license, and this will introduce more true institutional players and hopefully help clean up the space through market forces.

So to summarize, I think the trend going forward is going to be more regulatory tightening. We will see greater institutionalization of the stock market, and more globalization of the market and the fund managers. Such trends are in our favor since we've always built our organization from front to back office as an institutional quality firm.



Barry Lau: China is such a big market and so just philosophically speaking, we should have our own homegrown private fund managers that are more recognizable in size, stature, and fame. We are opening up the WFOE asset management program in China, and that introduces more foreign competition here.

The biggest funds, the most well-known names are already European or American names in the industry. For a market like China, which is, to put it generously, like a semi-close market, we should also strive to develop more of a mainstream local asset management industry with leading players from a homegrown domestic pool rather than introducing maybe too soon foreign competition.

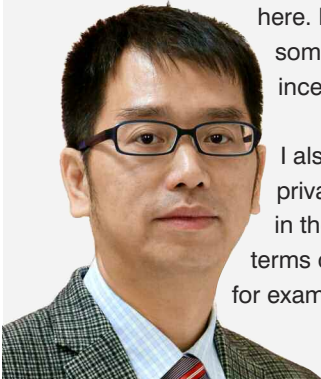
Now, having observed the development of the asset management industry in Hong Kong, the global who's who in the zoo has been in Hong Kong for a long time and they have a few men on the desk to run those operations. I am not 100% sure if this is a good model for growth, but at least a lot of foreign firms can say, "We've got a desk in China." But I do hope that at some point we will see a few more mainstream local indigenous fund managers that can command equal respect on the global level playing field amongst the very biggest and the very best of asset managers.



Barry Lau: For sure. We have to be mindful that in our industry, size does matter because you can build better infrastructure, you get better access to investors, better research, and better people, and maybe by protecting the industry a little more will mean that we have a better chance for local fund managers to really outshine the competitors from overseas. If you look at why typically American firms are much bigger and stronger has a lot to do with the baby boomer generation, and that after that era the pension fund system has been launched, et cetera. China is going that way too. There will be a lot more domestic capital available and they need more professional investors to help steer that capital to the relevant places. This will happen, but it's not going to be immediate. It will take 10 or 20 years to play out while at the same time the market may or may not want to wait for 10 to 20 years to allow foreign players to come in. So to me, it could be a matter of balancing, but again, I am talking purely based on philosophical preferences rather than what's actually happening.



Ming Pan: I view **foreign competition** for the China private fund industry as healthy for the mutual fund industry here. For example, quite a lot of the mutual funds in China have changed incentive structures so that some of the portfolio managers can share a part of the management fees. This is certainly a way to incentivize them to compete against the compensation structure in the private fund sector.



I also have some very good portfolio manager friends who have moved from the mutual fund side to the private fund side. I think they have done well in the mutual fund side and I think they would also do well in the private side. But I also believe that the mutual fund side should maintain some advantages in terms of access to sell side, research and other aspects of the business, like having fewer business risks, for example.

Steffen Gnutzmann

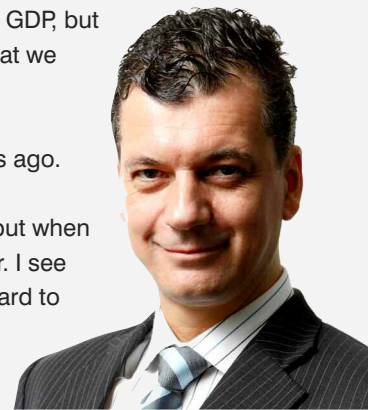
You mentioned business risk, and if you think about it, the product we are all talking about – investment funds – is quite an interesting animal. Different from say: a car or a TV set, a fund is a legal product. It actually doesn't exist. It is there because everybody believes it's there, just like money to some extent. So a fund is a legal product which needs its set of rules that everyone believes in and that are stable and that the users of this product can trust in, otherwise it will not succeed. And, the people in the industry will not succeed unless they have a trustworthy product.

Roland Schwinn: I agree. It's a matter of trust and a matter of stable legal structures based in stable regulatory environments. Finance, investments and capital markets are also based on comprehensive and reliable assessments whether the laws would also work together in case there would be an incident, for example in a default case. This is also part of our business is as a clearinghouse. So, wherever we go and offer certain clearing services, we need to make sure that the insolvency laws of the target jurisdiction are compatible with our existing home market regulation.

I wanted to share some general comments or observations about China. I actually think that in Europe there is a sort of **misperception** concerning China's economic situation. Some people have the view that a 6% GDP growth is kind of catastrophe for China, on the other hand no European state has a GDP growth of 6%. But my point about the misconception is that you have to look at the absolute figures.

Over the last 15 years, the US has grown their GDP by kind of 70%. Germany has doubled their GDP, but **China has more than eight-folded the GDP**. Sometimes the rest of the world tends to forget that we are talking about enormous absolute figures here.

So in terms of absolute figures, 6% now is of course much more than 12% just a couple of years ago. For me, it's always interesting whenever I come to China, in particular now, in contrast of to the overseas media articles which is usually about a China crisis and China going down the drain, but when you come here, I don't see any depressive people and I don't see too enthusiastic people either. I see very rational people here who believe in a sustainable and long term growth, and are working hard to make that sustainable, long term growth happen.



Steffen Gnutzmann

On the other hand, I spent some time here in the Pudong area yesterday, I walked up to the grand mall a few blocks over, floors one to five are - say - perfect. The prices in the shops are high compared to New York or Frankfurt. But if you go to floor seven or eight, well there are empty rooms and not so expensive restaurants.

Ming Pan

But you often find restaurants there. Given the massive e-commerce business, a lot of the retail shops like clothing stores are not really doing well, so you find more and more restaurants in malls.



Roland Schwinn: Whenever there are booms and subsequently slowdowns, of course you then have overcapacity. This happens everywhere in the world. If you go to Spain and look about the outer rings and suburbs of the Spanish cities, there is also still a lot of empty property from the last boom. We live in cycles.

Also in our world, the financial markets, we're dealing with non-linear financial markets, they rather go in cycles. But my point is that over the long run, my perception is that China is still experiencing good long term growth. Of course, that also happens in cycles and sometimes without sun or there is no rain, but there is also no valley without a mountain. My earlier point was therefore referring to the international public perception, which is of course also painted by the media.

Matthias Knab

Well, it's not just the overseas media, there are also international fund managers and financial analysts still bearish on China or at least talking about a China risk because there is too much debt, and that potentially China can put the whole Asian region and even the world economy at risk. Do you have any views on that?

Barry Lau: China is not building for today, not for tomorrow but for years to come. So, overcapacity is to be expected, these things take time. There are other macro constraints as to why there is overcapacity. Obviously, TMT and Alibaba amongst others help to drive down the retail. That explains why a lot of malls are not doing well. There are ways to cure it, but it's not going to be overnight. If you go to Taiwan, there are a few malls that have gone out of business, but you also find malls that are still there for good reasons because they have introduced a more experiential shopping concept.

My other point is that we Chinese, as a race, are generally extremely hardworking. I mean, all of you who have come from overseas have been to China many times, so you know people work hard, and I don't know whether this is just by our very nature of whether it's driven by needs or cultural background. People generally work hard here, just contrast that to Europe, I mean, do they now have a 40-hour or 35-hour work week? I don't remember, but that sounds like a luxury and more like a one-third of a job here in China.

When it comes to the media, journalists are great at writing about China and then Europe. But like Roland said, they forget about Spain, Portugal, Greece, and Italy. Those are countries which have their own specific sets of issues. Never mind about Cyprus, never mind about the new joiners. So we have got a fragmented collection of very different countries in Europe, and they are in very different situations and different cycles as well. At least China is more consolidated, but let me also add that it's all relative when I say "more".

As to the debt buildup, Qi has already mentioned the savings rate here in China that people would only be envious to have elsewhere in the world. 50% GDP is saved, that's a lot of savings here. You will probably not get rich investing in banks, but I also think Chinese banks are not as bad as what people are making them out to be from the media. If trouble comes, there is potentially a lot of government help, and in my opinion NPLs are really well-contained, it's not that bad.

And third and finally, the deposit to debt ratio is very well-controlled as well. So yes, the debt to GDP has really grown – depending on whose numbers you read, it ranges from 145% to 200% – but Japan has had that problem for decades and it still remains the third largest economy in the world.

So when you are in Japan, people may be spending less but you don't necessarily feel there's such a big debt bubble there. And final point, I just wonder when it comes to people who write about China or who complain about Chinese problems, how many times have they been to China? Which part of China have they seen, how well do they really know China? I think all of these are relevant and real questions that one has to grapple with and we should ask before reading blindly.



Roland Schwinn: By the way, the debt problem is a global one. It's a problem to be solved in many more countries, including the US and European countries. But I think there's another very important global theme which not only affects China and the global investment industry, which is the entire topic of **financial inclusion**.



Over the last years, there were certain developments in China which we have not seen anywhere else in the world. I'm talking about social media platforms like WeChat which started as a chatting platform and now has become a financial service provider on a very, very large scale in different areas. In China, WeChat is not even disrupting industries here but actually providing services which were not available before. Other countries would say disrupting because they may have had some of those services. I am talking about things like peer-to-peer lending, crowd funding, or payments which used to be dominated, at the least in the western world, by the banks, and which now is being taken on by smaller players, and of course, PayPal is already an old example for that.

My personal view is that these technologies and platforms will also spread into the financial investment industry. We have seen this already happening in the US and in Europe and it is slowly now picking up in Asia, with Japan being on the forefront here. One of the new buzz-words is **robo-advisory**. In the end, it's an automated platform which offers liquid instruments via an automatic intelligent advisory service to the masses, so not only the high net worth. So far, in most of the countries an intelligent provision of investment services was restricted to a very few only. But now you see a wave coming here in Asia where investment services are also offered to offer to the man on the street with a very low minimum investments hurdles.

I expect technology to have far reaching effects, also when we speak about an inflow of investments from Europe or the US. When ETFs in particular are made available also in Asia for a wider distribution and also being offered more actively, this will result once more in a mass inclusion of investors which were not included before, resulting in an acceleration and wider distribution of wealth also for the so-called underbanked.

I am coming back now to China, because China has shown how inclusion can happen in an enormous speed. We are at the point now where may other countries are looking at China and saying, *"What's going on here? How can we copy those models like WeChat or Alipay for our countries or for our business areas?"*

Connie Lee: We have a very fruitful discussion today. Before coming to the end of this Roundtable, let me give you some latest update on the new PRC tax rules that impact on the private equity funds. In particular, the PRC government intends to implement the Common Reporting Standard (CRS) from 1 January 2017. Under the CRS, financial institutions, including PE funds, are required to comply with the CRS reporting obligations. Specifically, PE funds would need to verify the tax residency of their investors, to perform due-diligence for the new fund investors. For accounts identified as non-resident, PE funds would need to report their financial account information to the State Administration of Taxation (SAT). In addition, the SAT has recently issued a circular which clarifies the treatment of value-added tax on IPO restricted shares and business tax on historical transactions. The recent domestic and international tax environment is changing rapidly. We, WTS, is experienced in providing tax advisory services to the fund industry. If you or your clients have any tax issues, feel free to contact me or Steffen and we are delighted to help you to solve out the tax issues.



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